Doing Business in Brazil

New tastes for opportunities in financial industry

Contents

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Beyond the wild landscape

History shows that the troubled times tend to offer key lessons to financial institutions. The 1920´s crises stimulated a stronger regulation in capital markets, for instance. Recent financial scandals initiated processes focused on transparency all over the world. The recent global credit crisis will also leave important lessons. One of them should be the urgency of devoting more attention to some alternative markets, including those distant from the most developed economies.

Understand the large, regulated, and sophisticated financial sector in Brazil

In a certain way, such new markets – especially emerging ones – may contribute to show that, beyond the turbulent landscapes of our times, there are new scenarios, new prospects, new opportunities. More than ever, financial institution leaders will try to understand how the emerging countries work.

Brazil, as a key emerging market, is no longer known only for its natural beauties, but also as a country really attractive to foreign investments. There is a growing number of investors and organizations interested in studying a country whose expansion has been fuelled by increasing domestic demand, sustained monetary easing, stock market development, continued credit growth, and improving labor-market conditions.

Under globalization, there is no place where one would be completely free from the impacts of an unprecedented crisis, as the one we still live nowadays. There are markets, however, where the chance of growth, renewal and recovery are stronger. Certainly Brazil is one of them.

This is one of the reasons why Deloitte decided to offer this publication to global financial institution leaders who want to achieve superior, sustained performance. Doing Business in Brazil reports market scenarios, trends, regulatory environment and other fundamental aspects to enable one to understand the large, regulated, and sophisticated financial sector of this country.

I hope you find this study useful and informative.

Clodomir Félix
Deloitte Financial Services Lead Partner in Brazil

The Brazilian financial system

Market overview

Brazil has a dynamic banking sector that represents about 8% of GDP (insurance services included). Following the trend dating to the second half of 2004, banking institutions have continued targeting their investments to credit operations. The volume of financial system credit increased from 24% of GDP in 2004 to 48% in December 2011.

The banking sector had approximately 2,218 firms by the end of 2011 (including holding companies, savings, commercial, development, and investment banks). The banking financial institutions provide services to the public through the following dependencies: branches, advanced service posts (PAA), banking service posts (PAB), electronic banking service posts (PAE), cooperative service posts (PAC) and correspondents, in addition to collection and payment banking posts (PAP) and rural credit advanced posts (PACRE), the last two no longer authorized by the Central Bank.

By 2011, there were about 21,278 branches, representing an increase of 15% versus the position of 2007. Though bank branches are the main type of service point, both regarding scope of services and free access by the general public, since 2002 the number of dependencies of this type grows more slowly than electronic service posts. This was an expected outcome in view of the technological advancements introduced by the need felt by institutions to cut costs, what triggered a deep rationalization of operating procedures by financial institutions. Another explanation for the lower pace of growth experienced by bank branches is the reorganization processes implemented by large network banks in the wake of acquisitions that took place in recent years. The network of correspondents increases faster than the number of branches too. They provide services that are structurally different and non exclusive of each other. Correspondents within the country constitute a further instrument for democratization and decentralization of financial services. Taking the physical, population and economic aspects, mechanisms that may facilitate the flow of funds between financially assisted municipalities and those that do not count on traditional assistance represented by bank branches and service posts is vital.

Regarding the widening of branches network, the number of new dependencies authorized to operate was expressive in 2006 (1,448 were bank branches). In the period, 6,620 correspondents in the country were authorized (disregarding the hiring of correspondents that are not subject to Central Bank authorization), what stresses the importance assumed by such mode of service to the population in recent years. Despite the investment in Brazilian financial market have been concentrated on short term operations and linked to the Selic (benchmark rate), the capital market has been growing rapidly albeit from a relatively low base. The volume of primary capital market offers, including stocks, debentures and promissory notes registered at the Securities and Exchange Commission (CVM) totaled R$36.7 billion in 2011, compared to R$16.3 billion in 2004. The process of monetary policy easing reinforced investor expectations about the economy. Since then, the volume and total value of private issues of stocks and private bonds has grown rapidly, and this may be expected to continue.

The insurance market is composed of approximately 114 companies at the end of 2011, according to SUSEP. At the end of 2011 total premiums within the insurance sector had reached R$105 billion, making Brazil the largest insurance market in Latin America. There were 368 closed pension funds holding R$597 billion in assets.

Brazil at a glance

The effectiveness of the macroeconomic policy adopted by the government was decisive for Brazil to get back on the track of recovery, easing inflationary pressures.

Brazilian economic indicators						Forecast
	2007	2008	2009	2010	2011	2012
GDP growth (%)	6.1	5.1	-0.6	7.5	2.7	2.1
Inflation IPCA – end-of-period (%)	4.5	5.9	4.3	6.5	6.3	4.9
Interest rate – end-of-period (% per year)	11.3	13.8	8.8	10.8	11.0	7.5
Exchange rate – end-of-period	1.8	2.3	1.7	1.7	1.9	1.8
Foreign trade balance (US$ billion)	40.0	24.7	25.3	20.3	29.8	19.1
Foreign direct investment, net (US$ billion)	34.6	45.1	25.9	33.0	66.6	55.0
Net public sector debit (% of GDP)	45.5	38.5	42.8	39.2	36.5	35.7

Source: Deloitte Brazil Research (based on Central Bank of Brazil data)

Note: Median of market expectations in June, 2012

- The path of growth – The economy has remained with a low growth and a relatively high rate in comparison of world economic figures and has needed infra-structure investments. The growth of industrial sector – one of the most important sectors in terms of job creation – has been complemented by strong commodity prices and exports. This sector (about 27.5% of the GDP) is capable of sustaining a higher rate of growth (4%-5% yearly growth), depending on foreign demand and a weaker currency.
- Positive evolution in the Brazilian equity and financial markets – Changes in the regulations at BM&FBovespa stock exchange led to an equity boom, with Novo Mercado – a set of corporate governance rules similar to those of U.S. Changes started in 2000 and in 2005 legislators simplified procedures for non-residents. Improvements in macro indicators fostered declines in yields of Brazilian sovereign bonds. Brazil has the largest Latin America market for hedge funds.
- Growth Acceleration Package 2 for 2011-2014 – Federal government announced R$955 billion growth acceleration package. The proposition is to promote growth without compromising macro stability.
- The country of renewable fuels – The International Energy Agency estimates that bio-fuels will represent 6% of the energy matrix by 2020 and Brazil is the second-largest producer and largest exporter of ethanol.
- Fiscal policy, debt sustainability and structural reforms – The fiscal policy is based in successive and high non financial public sector primary surpluses. The federal government has adopted Tax-Benefit System to reduce inequality and poverty.
- Micro reforms and market regulation – Governance Reform and institutional changes in Brazil to maintain the stable market rules.
- Sovereign risk and investment grade – The fundamentals of the economy and the international liquidity generated consistently positive flows of external resources, raising the international reserves stock to comfortable levels. Strategy to improve the macroeconomic stability in Brazil to promote the entrance of foreign investors created a good perception of the country for the international of risk classification agencies.
- Developments on Mercosul and international trade arrangements. The challenge of Mercosul and South America: towards union or disintegration and driving growth. Chinese trade impact on Latin American Emerging Markets: trade alliances, shared gains, asymmetric hopes and competitiveness.
- International scenario – A significant change in the Brazilian external position and the domestic improvement mitigate the impact of adverse external scenario characterized by heightened uncertainties, the crisis in Europe, financial markets volatility and economic activity deceleration.

Banks

The past several years of sustained economic growth have helped to bolster Brazil's banking sector, compounding the positive effects of years of reforms. Loans to the private sector and consumers have increased dramatically, and banks have reaped the rewards from providing these services. The sector is well regulated and supervised, following international best practices and guidelines. In addition, the existence of a well-developed secondary market as a hedge to systemic risk, a modern payments and settlement system, and stringent capital requirements all serve to buttress the financial structure from the ups and downs of international markets. These, combined with the participation of foreign institutions, have helped the sector weather multiple domestic and regional crises, including the International banking crisis of 2008. The sector also resisted to the negative effects from turmoil in the international capital markets in the recent years.

Ample liquidity, lower interest rates and increased consumer demand for credit have left Brazil's commercial banks – along with their much smaller Chilean counterparts – the most solid and profitable financial institutions in Latin America. Banks are also providing services to Brazil's large poor population, most often in the form of micro and payroll loans.

Growth in demand for personal credit was fostered through a combination of loans with lower interest rates and larger durations. Annual interest rates charged on personal credit transactions achieved 44.7% at end-2011 (which is a very high level in real terms); average duration achieved 18.7 months. By contrast, average corporate credit duration expanded achieved 13.3 months.

The Basel III increases the capital requirements for banks, but mainly improves its quality, to expand the capacity of institutions to absorb losses and resist further tightening of liquidity. The minimum capital of high quality will increase from 2% to 4.5% of risk weighted assets gradually between 2013 and 2015. The Tier I Capital, will increase from 4% to 6% by 2015. Banks also have to constitute gradually between 2016 and 2019, two capital buffers: a conservation of capital buffer equivalent to 2,5% of the assets weighted by risk and an additional buffer of up to 2.5% of core tier one capital to counter the economic cycle. Thus, the minimum capital requirements considering the two buffers can reach 13%.

According to the Financial Stability Report published by the Central Bank in March 2012, in the second half of 2011 the Basel ratio remained significantly above the national minimum requirement of 11%, registering 16.3% in December.

For the past several years, prudent economic management in the form of healthy fiscal and monetary policies, together with an improved current-account position, made the financial system less vulnerable to external pressures. As a result, the country has benefited from less volatile exchange and interest rates but has seen a steady appreciation of the currency.

The financial system has been undergoing a modernization process since 1988. At the heart of the reforms has been the creation of multipurpose banks (bancos múltiplos) and increased foreign participation in commercial banks. Most state banks have been sold to foreign and domestic institutions, although the two largest public-sector federal banks still account for 28.1% of the banking system's total assets. The banking sector has continued the trend towards consolidation that began in 1994, following the government's Real Plan to defeat hyperinflation. Commercial banks play the leading role in Brazil's financial structure. The segmentation of the sector has led to the formation of financial conglomerates, usually with a commercial bank serving as the mainstay of the group and selling the products of the other group members, including investment banks, insurers, and leasing and finance companies.

At the federal level, the government maintains a host of financial institutions that carry out certain functions, such as subsidising mortgages and engaging in development banking for particular industries and specific regions of the country. The state-owned Banco do Brasil – the country's largest financial institution – plays a key role in financing agricultural production throughout the entire country, especially for small farmers who generally do not meet commercial-bank loan requirements. In recent years, Banco do Brasil has increased its export-financing portfolio and stepped up banking services provided to lower-income Brazilians.

São Paulo serves as Brazil's principal financial and commercial centre. Brasília, the capital, is the seat of most government bodies. Some state agencies, banks and associations continue to have their headquarters in Rio de Janeiro, which was the national capital before 1960.

Banks – Opportunities

- The Brazilian financial sector is large and sophisticated. The foreign-owned banks represents only 17.6% of total assets.
- Economic stabilization, deregulation process, opening of the market to foreign insurers have impacted the insurance market.
- Brazil has an efficient capital markets and portfolio investment. Changes in the regulations at BM&FBovespa stock exchange led to an equity boom, with Novo Mercado – a set of corporate governance rules similar to those of U.S. Changes started in 2000 and in 2005 legislators simplified procedures for non-residents.

The industry in 2010

Country data	
Total GDP (US$ billion)	4,143
GDP per capita	12,689
Inflation rate (%)	6.3
Interest rate (% per year)	11

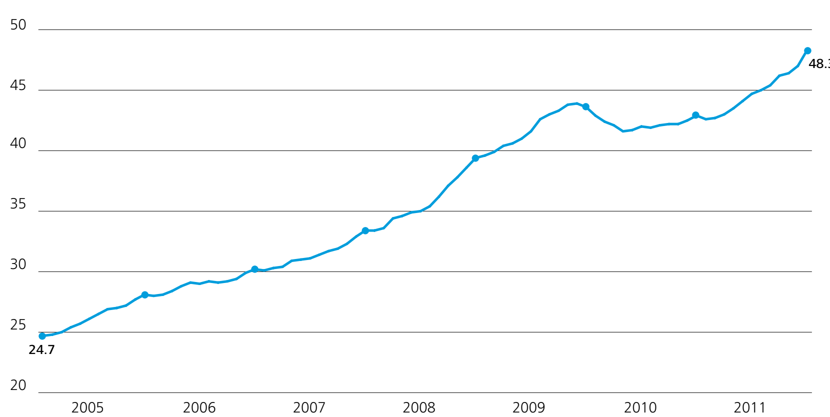
FSI dimention	
% of GDP	7.4
Banks – total lending to the private sector (%)	47
Insurance – premium (% GDP)	2.5
Capital market (IPO e follow-on)	18.3

Source: Deloitte Brazil Research

Bank credit to the private sector rises rapidly in face of moderate inflation. The credit operations have been fuelled by improving in labor-market conditions and the interest rates cuts.

Financial system credit operations

% of GDP



Source: Deloitte Brazil Research (based on Central Bank of Brazil data)

Banks – Global players

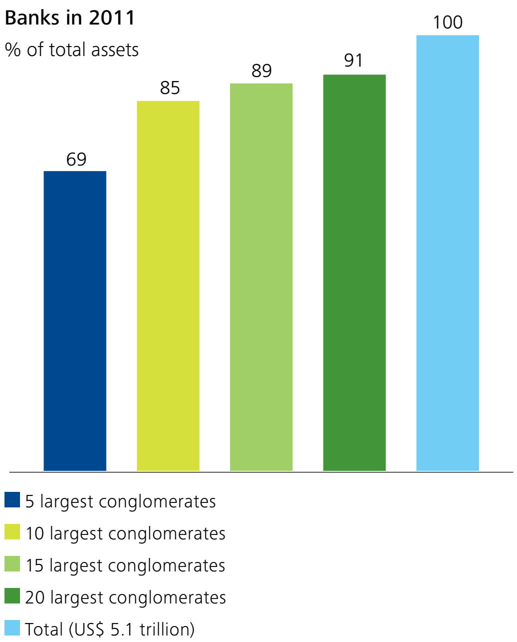
The strong position of the Brazilian domestic private institutions

Global Ranking	US$ billion		Location	Last Reported
	Market Cap.	Sales		
1 ICBC	241.7	71.2	China	December 2010
2 CCBC	200.9	58.1	Hong Kong	December 2010
3 JPMorgan Chase	179.2	58.3	USA	December 2010
11 Itaú Unibanco Holding	97.2	50.3	Brazil	December 2010
20 Bradesco	40.6	71.5	Brazil	December 2010
32 Banco do Brasil	34.8	51.4	Brazil	December 2010
44 Banco Santander	26.0	42.0	Brazil	December 2010

Source: Deloitte Brazil Research (based on Factiva, Dow Jones data)

Banks in 2011

% of total assets



Source: Deloitte Brazil Research (based on Central Bank of Brazil data)

Insurance

Brazil is the largest insurance market in Latin America and ranks 15th globally, according to the latest information from the Swiss Re survey. The Brazilian private insurance market remains proportionally small, despite the potential that exists for growth given the country's large population and stable economy. Premiums were equivalent to a modest 3.1% of GDP in 2010.

According to local press reports, analysts expect that the market will begin an upward trend as firms consolidate and the reinsurance market is opened to competition. There is a considerable degree of vertical integration between insurers and banks, with many of the larger banks – for example, Banco Bradesco, Banco Itaú-Unibanco and Banco Santander – offering a full line of insurance services. Large, stand-alone insurers include Porto Seguro, Sul América and Brasilprev.

The poor development of the sector stems from the high inflation and chronic macroeconomic instability that characterized Brazil until the mid-1990s. Such conditions made it impossible for individuals to make long-term financial decisions or to have any confidence in those who might promise to provide for them. As inflation expectations have eased over the past several years, the insurance market has started to respond. Insurance premiums amounted to R$90.1 bn in 2010, almost 17.6% above the figure for the previous year, according to the regulatory agency for the sector, the Superintendency of Private Insurance (SUSEP). Life insurance (including health insurance plans) amounted to 58% of total insurance premiums in 2010. Automotive insurance amounted to 23%, and property insurance amounted to 9%.

The insurance industry has performed well since pension reform in 2004, primarily in the life and pension sectors and with products aimed at small companies and individuals. Notably, the sector has benefited from the continued growth of a new life insurance plan, known as VGBL (Vida Gerador de Benefício Livre). VGBL is a long-term savings product, similar to a 401(k) plan, but created for individual employees rather than employers. A VGBL pays out funds to policyholders while they are still alive and includes several incentives, such as annual dividend payments and the ability to direct how a policyholder's funds should be invested.

Compared with regular pension plans, VGBL has a lower limit for monthly or annual contributions, and income tax is due only on capital gains at the time of withdrawal. The plan is attractive to taxpayers who already use their 12% deduction for social security payments on other types of social-security programmes and are not able to benefit from the tax discount provided for regular pension-plan contributions. VGBL premiums reached R$36.7 bn in 2010, a sharp increase from R$30.2 bn in 2009. VGBL policies amounted to 40.7% of total premiums in the insurance industry in 2010, according to SUSEP.

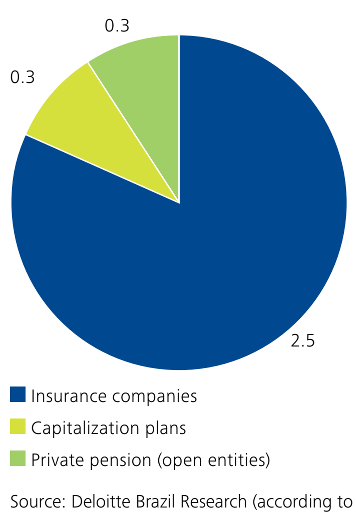
Foreign participation – The few remaining restrictions on the entry of foreign companies to the insurance and reinsurance market are slowly being eliminated. Companies are free to enter the market in association with a Brazilian company already operating in the area, but to operate independently they need authorization from the government.

The government sold the stateowned reinsurance company IRB-Brasil Resseguros and attracted the interest of major foreign companies, including Swiss Re, Munich Re, Transatlantic Re and Cologne Re. In addition to being a monopoly reinsurer, the company was also the reinsurance regulator. In a bid to open the sector to new companies, the government approved Supplementary Law nº 126/2007 in January 2007, which hands reinsurance regulation over to the National Council of Private Insurance (CNSP). SUSEP is responsible for sectoral supervision.

The new legislation allows three types of companies to begin operating in the reinsurance market in Brazil. "Local" reinsurers have registered offices in Brazil and are incorporated with the sole purpose of conducting reinsurance transactions. "Admitted" reinsurers have registered offices abroad and a registered representative office in Brazil. "Eventual" reinsurers are foreign reinsurance companies with registered offices abroad but without a representative office in Brazil. These firms must be registered with SUSEP to conduct reinsurance transactions in Brazil.

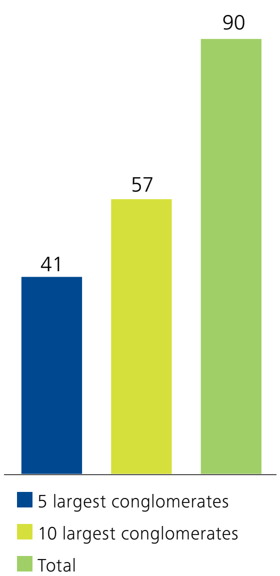
Insurance and pension dimension

% of total assets



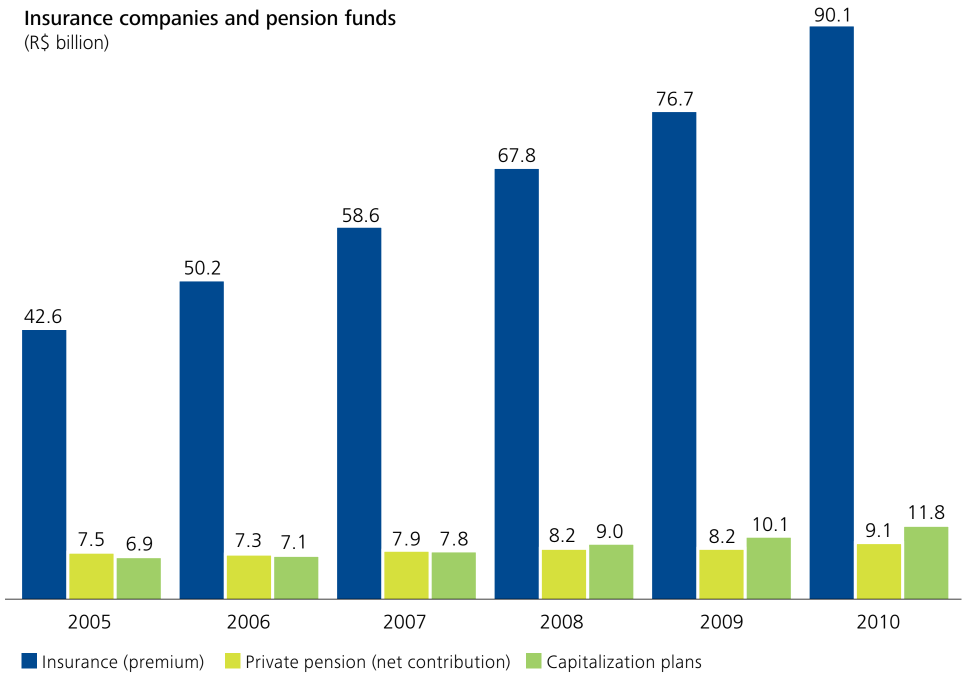
Source: Deloitte Brazil Research (according to Susep data)
Note: Insurance (premium); Private pension (net contribution); Capitalization plans (bonds)

Insurance market in 2010
Earned premiums



Source: Deloitte Brazil Research (based on Superintendência de Seguros Privado – SUSEP data)

Insurance companies and pension funds
(R$ billion)



Source: Deloitte Brazil Research (based on Superintendência de Seguros Privados – SUSEP data)

Insurance – Market player

Foreign companies are free to enter the market in association with a Brasilian company already operating in the area, but to operate independently they need authorization from the government.

Main insurance-companies in 2010 (R$ billion)

Top 10 conglomerate	Earned premium	% Composition
Bradesco Vida e Previdência	14.7	16
Itaú Vida e Previdência	7.8	9
Brasilprev Seguros e Previdência	7.6	8
Santander Seguros	5.9	7
Itaú Seguros	4.6	5
Porto Seguro	4.2	5
Bradesco Auto/Re	3.7	4
Caixa Vida e Previdência	3.0	3
Mapfre Vera Cruz Seguradora	2.8	3
Sul América	2.5	3
Other	33.3	37
Top 10	**56.8**	**63**
Total Insurance	**90.1**	**100**

Source: Superintendência de Seguros Privado – SUSEP data

Regulatory environment

Background

The Brazilian financial supervisory system has developed gradually, primarily during the second half of the twentieth century, and mostly in response to various pressures, financial crises, and changes in the nature of financial services over time.

In the mid-1960s, following the implementation of the macroeconomic stabilization plan, the Government Plan for Economic Action, a need for restructuring the financial system was identified, leading to the passage of the "National Financial System Law, which continues to be the principal legislation underpinning the Brazilian financial markets. The act established the National Monetary Council (CMN) through which all major monetary and financial resolutions are issued today, and which includes the Minister of Finance, the Minister of Planning and the Governor of the Central Bank.

The Central Bank of Brazil (BC) was also created by Law 4,595/64. The BC is an autonomous federal institution that took over the functions of a monetary authority. These functions were previously performed by the Currency and Credit Superintendence (SUMOC), Banco do Brasil (BB) and the National Treasury. Although some improvement was achieved through the creation of a formal Central Bank, the institutional process was not complete. The BC become the currency issuing bank, but acted according the needs of the BB. The BC was the bank of banks but was not the only holder of deposits from financial institutions since many institutions placed their voluntary reserves in BB. Nonetheless, the BC was the government's financial agent in charge of managing the federal public debt. It was not the cashier to the National Treasury since this was also a function of BB.

The 1960s and 1970s saw reforms aimed at fostering the emergence of a capital market and enhancing supervision through the 1976 establishment of The Securities and Exchange Commission (CVM).

By the 1980s, Brazil was experiencing rapid inflation and a prolonged economic crisis, leading to a drastic fall in demand for bank loans, increases in liquidity, and significant decreases in credit volume. However, financial institutions succeeded in maintaining relatively high profits due to income from non-interest-bearing deposits. While banks' assets became increasingly concentrated in highly-liquid government securities, the government abolished the charter requirement for setting up new institutions and authorized the incorporation of multi-purpose banks, which led to an increase in the number of banks.

Then, in 1985, the government further reorganized the financial supervisory structure. The main change was the removal of the financial linkages and overlapping functions between the BC, the BB, and the National Treasury. In 1987, the automatic transfer of funds from the BC to the BB was eliminated, which had hampered the BC's management. Through 1988, full monetary authority was progressively transferred from the BB to the BC, while atypical activities carried out by the BC (such as those related to economic incentives and administration of public debt) were transferred to the National Treasury.

The 1988 Constitution continued the clarification of the BC's role, explicitly assigning to the BC the responsibility of issuing currency and specifying that its board, which is appointed by the President, requires Senate approval. The 1988 Constitution forbade direct or indirect granting of loans to the National Treasury and called for a Complementary Law of the National Financial System to replace the National Financial Systems Law of 1964.

Brazil experienced further economic strains in the early 1990s. In July 1994, inflation rates reached almost 46 percent per month and the Real Plan was enacted to cut inflation. A systemic crisis was eminent; seven small banks filed for bankruptcy. In 1995, after 13 other bankruptcies, the BC intervened at the Banco Economico (a large Brazilian bank) to avoid a bank run. To address this crisis, in late 1995, the government announced a strategy that included a commitment to bear the costs of losses instead of the banks' creditors in order to encourage mergers and acquisitions of the banks facing difficulties.

In response to the bank failures, a further, more fundamental restructuring of the banking system safety net was implemented. Prudential regulations were enacted and supervision was strengthened to ensure safety and soundness of the financial system. In addition, other changes were instituted, including a direct line of liquidity and the creation of a deposit insurance scheme. In April 2002, the payment system (SPB) was reformed. Within the new system framework, the BC would not accept negative balances on the reserve accounts of any bank at any time.

After a period of reasonable stability, the second semester of 2007 represented the start of a process of bursting the American real estate bubble for the high risk mortgage market resulting in a drop in real estate prices in that country. In the first semester of 2008 the effects on the stock market were visible and in September of that year, the major international financial crisis began leading to the extinction of banks such as Bear Stearns, Lehman Brothers and Washington Mutual, among other institutions that went through difficult times. However, in spite of the reduction in liquidity caused by the restriction of credit during the end of 2008 and most of 2009 which impacted GDP growth that year and the fall of the stock exchange, the perception in Brazil is that the effects of the crisis were marginal, due to a comfortable situation with respect to international reserves and a solid financial market carefully monitored by the Central Bank of Brazil. In 2009, the São Paulo Stock Exchange index (Ibovespa) showed an increase of approximately 80% in reals and 140% in dollars and the economy showed signs that it was quickly recovering from the effects of the crisis, a scenario confirmed in 2010.

The first semester of 2011 was marked by great volatility on the international scene. The fiscal deterioration of countries in the Euro zone brought back the risk of a new global financial crisis. The political pressure to reduce the fiscal deficit was also high in the United States and led to the lowering of the American debt rating from AAA to AA+ by Standard&Poor's on August 5. In addition to the fiscal issues, the return of doubts in relation to the international growth rate, especially in the United States and China, also exerted negative influence on the international scenario. Although the Brazilian economy would continue to show signs of apparent solidity, at that economic time, the overvalued real was hurting exports even more and inflation was worsening as a result of the exaggerated increase in commodity prices.

Year	Growth GDP (%)	Inflation (%)	US$/R$	Ibovespa
2000	4.3	5.97	1.95	15,259
2001	1.3	7.67	2.32	13,577
2002	2.7	12.53	3.53	11,268
2003	1.1	9.30	2.88	22,236
2004	5.7	7.60	2.65	26,196
2005	3.2	5.69	2.34	33,456
2006	3.7	3.14	2.13	44,474
2007	6.1	4.46	1.77	63,886
2008	5.2	5.90	2.33	37,550
2009	-0.6	4.31	1.74	68,588
2010	7.5	5.91	1.70	69,304
2011 (Forecast)	3.30	6.52	1.73	52,324 (Set 11)

Source: Central Bank of Brazil

As for insurance, Brazil's government has regulated all insurance and reinsurance operations since 1966. It created the National System of Private Insurance, which was formed by the National Private Insurance Council (CNSP), the Private Insurance Superintendence (SUSEP), Brazil RE and companies that operate in private insurance as well as qualified brokers. In 1967, the National System of Capitalization was created. In 2003, SUSEP began a modernization process based on the IAIS Core Principles.

In 2007, Complementary Law 126 eliminated the previous state monopoly of reinsurance. CNSP became the regulator for co-insurance, reinsurance and retrocession transactions with regulatory supervision provided by SUSEP. IRB Brazil RE would continue to operate as a local reinsurer only.

Closed pension funds have been regulated since 1977 when these funds were designated as depository institutions. The law was updated in 1998 and 2001 with general rules to define the relationship between the government bodies and their respective pension entities.

Statutory framework

The fundamental law of Brazil's financial system is the National Financial System Law (Law 4,595/64), effective since 1964, creating the CMN and the BC. The CMN was given the responsibility for formulating monetary and credit policies, whereas the BC is responsible for executing those policies. Resolutions can be issued without Congressional approval if they comply with the existing law.

Law 6,024/1974 deals with issues of intervention and judicial liquidation. Related to this law is Executive Act number 2,321/87 which institutes the Special Temporary System of Administration. Together these two pieces of legislation allow the BC to place companies into administration and remove or replace a company's board of directors.

Law 7,492/1986 defines financial crimes and related penalties. This includes, but is not limited to, unauthorized bond issuances, omission of relevant information and fraud against the supervisory process. Law 9,613/1998 defines money laundering crimes and associated penalties. Law 9,613 established the COAF (Council for Financial Activity Control) which is responsible for the enforcement of anti-money laundering activities.

Law 9,447/1997 increased the formal powers of the BC, allowing the BC to take preventative measures, such as requiring capitalization, transfer of shareholder control and/or stockholder structure reorganization (acquisition, merger or split-up). Various other legislative actions provide the BC additional powers and establish standards within the financial services industry.

The Brazilian Corporate Law was amended by Law 11,638/07, which is detailed in the Accounting Principles section. The Central Bank of Brazil, in turn, through Notice nº 16,669/08 informed the market of the procedures for adaptation of the accounting and auditing standards applicable to financial institutions and other institutions authorized to operate by the Central Bank of Brazil to the provisions of Law 11,638, of 2007.

The main laws that guide the securities industry are Law 6,385/1976 (the "Corporate Law") and Law 6,404/1975 (the "Corporation Law"), amended through Law 9,457/1997, Law 10,303/2001, Law 11,638/2007 and Law 11,941/2009, respectfully.

SUSEP was created by Decree-Law 73/1966 and Decree 60,459/1967. These decrees regulate capitalization companies and, along with Complementary Law 109/2001, set the guidelines for pension funds, which is supplemented by other laws dealing with SUSEP's prudential functions.

In 1998, Constitutional Amendment 20 provided legislative guidance for complementary pensions. Additional guidelines were addressed in Complementary Law 109/2001. Article 74 of this law established the Complementary Pension Council (CGPC) as the primary regulator and establishes the National Superintendency of Pension Funds (Previc) as the provisory supervisor. MPAS Resolution 01/1986 established the oversight for closed pension fund entities. Standards including prudential limits are further described in Complementary Law 109/2001 and CMN Resolutions 3,792/2009 and 3,846/2010.

Non-statutory elements

Many of the Brazilian financial market operators have established self-regulatory components. For banking activities, the Brazilian Federation of Banks (FEBRABAN) has components of self-regulation which include principles of transparency, fair competition, confidentiality, and compliance with formal rules and regulations.

Within capital markets, the National Association of Investment Banks (ANBID) established in 1998 five codes for self-regulation relative to investment funds, public offerings, qualified services to capital markets, private activities and the qualified certification program.

The National Association of Financial Market Institutions (ANDIMA) was established in 1971 and its members include commercial, multiple and investment banks, as well as stockbrokers and securities distributors. The group has a formal Code of Ethics as well as formal standards of conduct.

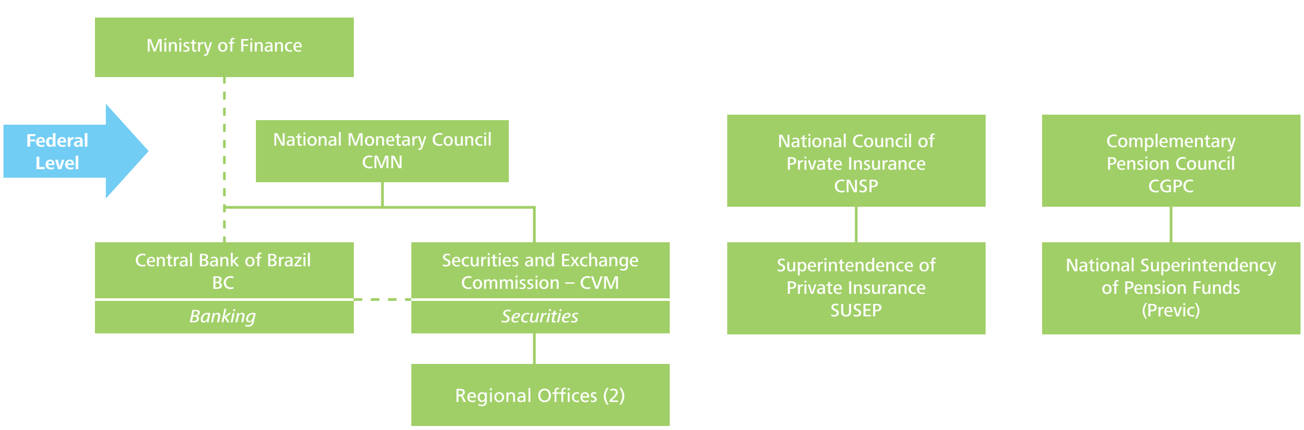
In 2009, the ANDIMA merged its activities with those of the ANBID and, together, formed the Brazilian Association of Financial and Capital Market Entities (ANBIMA), becoming the representative of the institutions that operate in the financial (investment banks) and capital markets, acting as a private regulatory agent, supervising the compliance to the rules provided in its Auto-Regulation and Best Practices Codes.

Within the insurance industry, there is a published Code of Ethics of the National Federation of Insurance Companies (FENASEG) which addresses general principles, institutional responsibility, social responsibility, ethics and internal relations, ethics and consumer relations, fraud and money laundering, and established a Market Disciple and Ethics Council.

Institutional structure

National Monetary Council – The National Monetary Council (CMN), in addition to management of liquidity, protection of the currency and coordination of monetary, fiscal and credit policies, has supervisory responsibilities which include:
- Guiding the allocation of funds by financial institutions
- Improving financial instruments and institutions
- Monitoring financial institution liquidity and solvency.

Regulation and supervision entities



The CMN has authority to draft regulations implementing the laws issued by the National Congress. The rules issued by CMN, typically referred to as "Resolutions", must be adhered to by all the members of the financial system, including the BC and the CVM.

The CMN is comprised of the Minister of Finance (Chairman), the Minister of Planning and the Central Bank Governor, all of whom are appointed by the Brazilian President.

Central Bank of Brazil (BC) – The BC is responsible for maintaining national currency purchasing power as well as monitoring the stability of the financial system. It has the formal authority for supervision of all financial institutions as well as licensing responsibilities.

As the monetary authority, the BC acts as the lender of last resort. The BC has the authority to intervene as necessary and liquidate financial institutions if there is a threat to the safety and soundness of the financial system.

The BC has seven main areas of operations, each run by a Deputy Governor: administration, Financial System Organization and Controls Over Agriculture Credit, international affairs and management of corporate risks, monetary policy, supervision, financial system regulation, and organization and economic policy. The BC generates income from its activities as monetary policy executor and from the Treasury budget. Any profits are returned to the Treasury and any losses will be covered by the Treasury.

Securities and Exchange Commission (CVM) – The CVM oversees and supervises the stock market and other securities activities (debentures, commercial papers, stock index futures, stock options, over-the-counter markets). The CVM also supervises the institutions operating in the capital markets as well as the listed companies. The CVM has the legal duty to protect securities holders against fraudulent issues and/or illegal actions, as well as ensuring fair trading practices including access by the public to accurate and relevant information.

The CVM is overseen by one governor and four deputy governors, all of whom are appointed by the President of Brazil and approved by the Senate.

National Council for Private Insurance (CNSP) – The CNSP establishes the guidelines and regulations for the private insurance market. It is run by the Minister of Finance (its chairman) and representatives from the Ministry of Justice, the Ministry of Social Security, the BC, the CVM, and the Superintendent of SUSEP.

Superintendence of Private Insurance (SUSEP) – The SUSEP, an autarchy created by the Decree-law 73/66 directly linked to Ministry of Finance, is the xecutive body of the politics delineated by the CNSP and is also the insurance commissioner, responsible for the supervision and control of the insurance, open private pension funds and capitalization markets in Brazil.

SUSEP's objectives are to ensure that market participants remain solvent and to promote customer protection. SUSEP has four main departments: administration, actuarial techniques, economic control, and supervision. SUSEP's annual budget is a portion of the government's annual budget. Fees and fines collected from supervised institutions accounted for approximately 79% of their 2010 income. The Complementary Pension General Council supervises closed pension funds in conjunction with the SPC and is funded via receipts from the Treasury.

National Superintendence of Pension Funds (PREVIC) – The PREVIC is a self-managed federal entity tied to the Social Security Ministry, created by Law 12,154 of 2009, which operates as the enforcement and oversight body of Closed Supplementary Pension Fund Entities (EFPC) and as executor of policies for the supplementary pension scheme operated by these companies. PREVIC took the place of the Secretariat for Supplementary Pension Funds (SPC).

National Supplementary Pension Fund Council (CNPC) – The CNPC is the body responsible for regulating the activities of closed supplementary pension fund entities, operating further as the appellate body for PREVIC decisions. The CNPC, current name for the former General Supplementary Pension Fund Council (CGPC), is presided over by the Social Security Minister and composed of representatives of the Ministry of Planning, the Civil House and the Treasury, in addition to pension funds, participants, beneficiaries, and sponsors and founders of pension funds.

According to the Organization for Economic Cooperation and Development (OECD), Brazil has the eighth largest pension fund system in the world, considering the total funds managed. The pension system has 337 closed supplementary pension fund entities, 2,815 pension plans, 3,2 million participants and beneficiaries and assets of approximately R$602,6 billion, according to the latest data consolidation made by PREVIC in December 2011.

Enforcement and prosecution

The BC has broad powers to take actions to safeguard banking activities and depositors and creditors with the goal to maintain financial stability. These powers include warnings, fines, suspensions and temporary disqualifications. When a situation of non-compliance with minimum capital and net worth requirements or excess risk is identified, one measure that has been taken by the BC has been the commitment by the institution's management through a commitment letter to implement specific restructuring or capitalization plans.

The CVM has similar powers within the securities industry. The Law 6,385/76, which governs the securities market, states that CVM shall perform the duties provided for under the Law in order to "protect securities holders and market investors (…) against illegal acts of officers and controlling shareholders of publicly held corporations, or managers of securities portfolios". Law 6,385 requires that the accounts of listed companies, and other companies regulated by CVM, be audited. There are a number of applicable requirements under relevant laws and rules that seek to ensure the independence of external auditors in Brazil. In that regard, external company audits may only be carried out by audit firms or independent accounting auditors registered with the CVM. These auditors are subject to the rules of the CVM and the Federal Accounting Council, and also the Independent Auditors' Institute, with regard to professional conduct. The BC adopts the same procedure for financial institutions. The CVM may impose penalties on auditors and audit firms, including warnings, fines, suspension or cancellation of authorization or registration, where they acted in breach of the securities or company laws and regulations.

SUSEP improves quality of the regulation and the veracity of supervision of the insurance sector. Regulatory improvements include, for the new life insurance products, a requirement for prudent actuarial evaluations, implementation of Liability Adequacy Test (LAT); new requirements for a solvency margin and additional capital for subscription and credit risks.

Framework for coordination

Coordination between the governor of the BC and Minister of Finance occurs through the CMN. Membership of the CMN allows for sharing of information related to supervisory actions of the BC. Coordination between the BC and the CVM is based on standards set by the CMN.

In addition, the BC has two agreements in place with other agencies addressing matters of coordination and cooperation: an agreement between the BC and the CVM of October 2010 and amendments which concerns exchange of information and other activities to better perform respective tasks; and, an agreement between the BC and the SUSEP of July 2005, concerning the coordination of activities and information exchange.

International coordination

The BC works closely with other international supervisory agencies and has formal agreements with various countries, including Germany, Argentina, Bahamas, Spain, USA, Cayman Islands, Mexico, Panama, Portugal, Uruguay and Paraguay.

The CVM participates in international financial services working groups, such as the International Organization of Securities Commission (IOSCO), the Council of Securities Regulators of America (COSRA), and the Ibero-American Institute of Securities Regulators (IIMV).

The SUSEP is also pursuing implementation of enhanced international practices through participation in the International Association of Insurance Supervisors (IAIS). Previc has been exchanging information with the OECD regarding implementation of practices relative to the closed pension funds.

Current issues

There are issues regarding financial system regulation that are currently being considered by Brazilian regulators and policy makers. In addition to ongoing efforts relating to Basel II and Basel III implementation another area of reform is related to the establishment of internal capital assessment process already regulated by the Central Bank of Brazil Resolution n° 3,988/11. Additionally, since 2007 the BC has been closely monitoring bank clients charges and regulating the management process for bank client complaints, also requiring that ombudsman departments be established.

With the opening of the reinsurance market in Brazil, many insurance companies have begun engaging in reinsurance operations with reinsurance companies of the same economic-financial group located abroad. In 2011, the CNSP, through Resolution 232, limited the volume of reinsurance operations with companies of the same financial group headquartered abroad to 20% of the premium corresponding to each contracted coverage.

Another topic under discussion is competition within the banking industry. The BC has the authority to approve mergers and to investigate conduct. However, the main antitrust authority in Brazil, the Administrative Council for Economic Defense (CADE), appointed by the Judiciary, is responsible for judging competition within the banking sector. To address this overlap of duties and responsibilities, the government presented a bill which is under consideration by Congress. The bill calls for the Brazilian System of Defense of Competition (SBDC) to oversee mergers of financial institutions only if there is no systemic risk related to the merger. If the merger could impact the soundness of the financial system, the BC will retain ultimate authority.

Another issue under discussion is the Competition Protection Code (CPC) established in 1990. From 1990 until June 2007, there was confusion in the marketplace as to the applicability of the CPC to banking consumers. Banks had claimed it was not applicable; however, the Federal Supreme Court ruled against the banks' claims and confirmed that the CPC does apply to banking consumers.

Accounting principles

Law 11,638

The accounting principles and standards generally applicable in Brazil are established by Brazilian corporation law and include the technical guidelines issued by the Accounting Pronouncements Committee (CPC). Those accounting principles and standards, in the case of listed companies under the jurisdiction of the CVM, are complemented by certain additional instructions issued periodically by the CVM. Such standards differ in certain material aspects from the accounting principles and standards generally accepted in the United States of America.

In addition, the CVM and other regulatory entities such as the Superintendence of Private Insurance (SUSEP), the Central Bank of Brazil provide additional industry specific guidelines and Previc.

The financial statement provisions of the Brazilian Corporation Law are applicable to all companies incorporated as sociedades anônimas, including public companies (companhias de capital aberto) registered with the CVM. Law nº 11,638, however, introduces a new requirement for certain other large companies not incorporated as sociedades anônimas to prepare annual financial statements in accordance with the financial statement provisions of Brazilian Corporation Law, including those new provisions introduced by Law nº 11,638, and requires that these financial statements be audited by an independent auditor registered with the CVM. Such large companies, as defined therein, are entities or group of entities under common control, that have more than R$240 million of assets or more than R$300 million of gross revenues, both measured as of and for the prior fiscal year. Furthermore, private companies (companhias de capital fechado) subject to the financial statement provisions of the Brazilian Corporation Law may choose to prepare such financial statements in accordance with standards issued by the CVM.

The changes and requirements introduced by Law nº 11,638 become effective for fiscal years beginning on or after January 1, 2008 however are subject to additional interpretation and regulation by applicable regulatory agencies (which in the case of the Issuer shall be the Central Bank) and accounting standards bodies in Brazil.

IFRS x Brazilian Gaap

The Brazilian Accounting Framework and practices adopted by the financial institutions authorized to operate by the Central Bank of Brazil, Insurance Companies, Investment funds may differs in certain aspects from IFRS, as showed below

Up dated status by Regulator			
Financial institutions authorized to operate by the Central Bank of Brazil	Insurance Companies	Pension Plans	Investment Funds
At the current stage, only 6 norms issued by the CPC have been approved by the BC, but all the financial institutions established in the form of public corporations or which are required to establish auditing committees have begun, since December 31, 2010, to annually release consolidated financial statements adopting the international accounting standard in accordance with the guidelines issued by the International Accounting Standards Board (IASB), translated into the Portuguese language by a Brazilian entity accredited by the International Accounting Standards Committee Foundation (IASC Foundation). This determination also applies to institutions established in the form of private companies which are leaders of conglomerates made up of institutions established in the form of public corporations. **CPCs approved so far** a) CPC 01 – Reduction to the recoverable value of assets – approved by BC Resolution nº 3,566/08; b) CPC 03 – Cash flow statement – approved by BC Resolution nº 3,604/08; c) CPC 05 – Disclosure of related parties – approved by BC Resolution nº 3,750/09; d) CPC 10 – Payment based on shares – approved by BC Resolution nº 3,989/11; e) CPC 24 – Subsequent event – approved by BC Resolution nº 3,973/11; and f) CPC 25 – Provisions, contingent liabilities and contingent assets – approved by BC Resolution nº 3,823/09.	At the current stage the following pronouncements has been approved, through Bulletin 424/2011: CPCs 1 to 13, 15 to 41 and 43 (the CPC 14 was replaced by 38 and 39). Additionally, SUSEP required preparation and release of anual (December of each year) consolidated financial statements in accordance with the international accounting standards issued by the International Accounting Standards Board (IASB).	The statement applicable for pension plans refers to IAS 19 - Employee Benefits issued in Brazil by CPC 33.The statement IAS 26 Accounting and Reporting by Retirement Benefit Plans, remains under review by CPC. Throughout the year 2012 the committee will discuss the plans of PREVIC (Brazilian pension funds regulator).	Still pending regulation by the Securities and Exchange Commission (CVM). July 18 was the deadline for comments on the exposure draft related to disclosure of information on transactions with related parties in the financial statement accompanying notes for investment funds and on accounting standards applicable to real estate investment funds.

SUSEP, in order to monitor the updating of Brazilian corporate law to enable the process of adapting Brazilian accounting practices to the international accounting standards (IFRS), issued Bulletin 379/08, amended by Bulletin 385/09, which approved guidelines and interpretations (CPCs 1 to 10 and 12 and 13) issued by the Accounting Pronouncements Committee (CPC), effective beginning January 1, 2009.

In 2009, new pronouncements and interpretations were issued by the CPC, later amended by SUSEP through Bulletin 424/2011, which approved the following pronouncements (CPCs 11, 15 to 41 and 43), effective starting January 1, 2011.

Additionally, SUSEP through Bulletin 424/2011, required preparation and release of annual consolidated financial statements in accordance with the international accounting standards issued by the International Accounting Standards Board (IASB).

Anti-Money Laundering Law*

In the Brazilian state structure for prevention of money laundering, the COAF stands out, an intelligence unit created within the Finance Ministry by Law 9,613/98 with organization and structure defined by Decree 2,799/98. It is a collective decision-making body whose plenary is composed of representatives of the Central Bank of Brazil (BC), the Securities and Exchange Commission (CVM), the Superintendence of Private Insurance (SUSEP), the Attorney-General of the National Treasury (PGFN), the Internal Revenue Service (SRF), the Brazilian Intelligence Agency (ABIN), the Federal Police Department (DPF), the Ministry of Foreign Affairs (MRE), the Federal Comptroller General (CGU), the Ministry of Social Security (MPS), and the Ministry of Justice – Department of Asset Recovery and International Legal Cooperation (DRCI).

*Source BC

Pursuant to the Brazilian anti-money laundering law, financial institutions must:

- identify and maintain up-to-date records regarding their customers;
- maintain internal controls and updated registration information of its customers;
- record, for a five-year period, any transaction or set of transactions performed by individuals or entities pertaining to the same economic group involving Brazilian and foreign currency, securities, metals or any other asset which may be converted into money that exceeds the limit set by the competent authority;
- review transactions or proposals with characteristics which may indicate the existence of a crime;
- keep records of transactions involving checks for a minimum period of 5 years;
- inform the appropriate authorities (without the customer's knowledge) of any transaction or set of transactions performed by individuals or entities pertaining to the same group of companies; and
- communicate to the appropriate authorities, within 24 hours, any suspicious transaction.

In addition, the Brazilian anti-money laundering law created the Financial Activity Control Council. The main role of the Council is to promote cooperation among the Brazilian governmental bodies responsible for implementing national anti-money laundering policies, in order to avoid the performance of illegal acts and frauds.

In 2009, in addition to the rules mentioned above, the Central Bank issued a updated regulation whereby financial institutions must follow certain special procedures concerning banking transactions of public politicians. Therefore, the financial institutions also must:

- Identify public politicians, or members of their families, when reporting a suspicious transaction involving such individuals to the Central Bank; and
- Structure their internal procedures in order to identify public politicians and their sources of funds used for certain transactions. The financial institutions may consider the compatibility of such transactions with the information available in their systems regarding such person's assets.

Additionally, the Central Bank has adopted specific regulations to prevent financial transactions in connection with terrorism, releasing, through its website, bulletins related to the approval of group notices about financial actions against money laundering and financing of the terrorismo.

In addition, SUSEP, through Bulletin 380/2008, established specific internal controls to prevent and combat "laundering" crimes or hiding of goods, rights and values, as well as for the prevention and coercion of terrorism funding.

Ombudsman Department

Central Bank of Brazil Resolution nº 3,849/10 establishes that financial institutions and other entities authorized to operate by the Central Bank of Brazil are required to create an Ombudsman Department, independent from Internal Audit, and compatible with the nature and complexity of their products, services, activities, processes and systems.

The Ombudsman Department needs to meet the aspects addressed by said Resolution, taking into consideration efficiency in responding to clients' complaints and opinions, internal handling of deficiencies identified in operating processes, staff training, semiannual reporting to the Central Bank of Brazil, and adding value to the Bank's business and internal control through appropriate reporting to Senior Management on the nature of these demands.

Minimum criteria to assess the appropriateness of the Ombudsman Department structure, systems and procedures pursuant to the requirements of Resolution nº 3,849/10 of the National Monetary Council. These criteria will be assessed in relation to the specific situation of each institution and, according to the schedule set by said Resolution as subsequently amended.

Basel I and II

The Basel Accord establishes more complex and extensive requirements for allocation capital that already has significant impact in the financial institutions.

The Basel II Accord is based on three pillars to ensure the security and reliability of the international financial system, as follows:

Pillar 1 – Capital requirement	Pillar 2 – Process of capital review, assessment and planning	Pillar 3 – Transparency and market discipline
Credit risk (standard, basic or advanced)	Oversight by the Board and Management	Disclosure policies
Market risk (standard or advanced)	Rigorous assessment of capital	↓ **External information disclosure**
Operational risk (basic, standard or advanced – AMA)	Complete risk assessment	
↓ **Calculation of PER**	Oversight and information	
	Internal control	
	↓ **Capital management structure / ICAAP**	

The Basel II Accord establishes more complex and extensive capital allocation requirements which will have significant impacts on financial institutions. The Central Bank, by means of Bulletin nº 19,028/09, changed the schedule for implementation of Basel II in Brazil, adjusting Bulletins nº 16,137/07 and nº 12,746/04.

Basel II Schedule

Schedule Key Points	Prior Periods	2009	2010	2011	2012	2013	
Governance structure	RM RO		RC				All financial institutions
Classification of operations	RM						
Calculation of the capital portion	RM RC RO						
Key database points for internal models		RC RO					Candidates for internal models only
Eligibility criteria for internal models		RM	RC	RO			
Authorization release process for internal models							
Start of authorization for use of internal models							

RM Market Risk RC Credit Risk RO Operational Risk

The Basel II rules substantially changed the Basel I rules:

- Inclusion of operational risk.
- Change in the portion of market risk (Brazil) and credit risk (global).
- Introduction of the ICAAP (Pillar 2).
- External disclosure requirements.

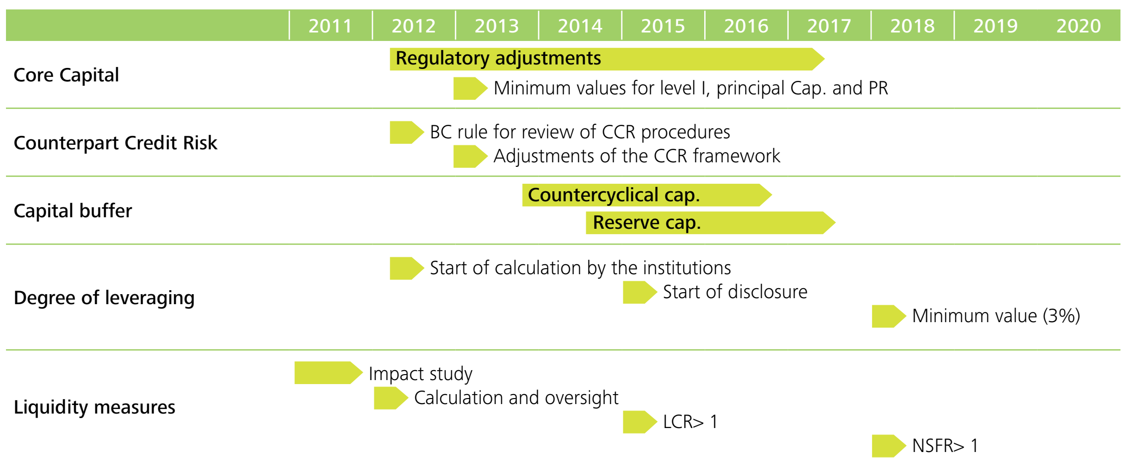
Basel III, in turn, is incremental to the Basel II requirements, focused on:

- Improvements in capital quality.
- Countercyclical measures / capital buffers.
- Degree of leveraging.
- Liquidity risk.

Failures of the recent banking crisis	Main highlights of Basel III
• Excessive leveraging included and not included in the balance sheet of the banking sector; • Low level and quality of the banks' capital base; • Insufficient liquidity buffers; • Insufficient communication between decision-makers and technical staff; • A focus on income; • Cyclical deleveraging.	• Increase the quality of regulated capital; • Improve various aspects of the practices used to manage risk, quantitatively an qualitatively; • Introduce a maximum leveraging percentage; • Measures to prevent cyclical effects; • Address systemic risk and interconnectivity; • Introduction of a global liquidity standard.

December 2009	"Consultative proposal to strengthen the resilience of the banking sector" annonced by the Basel Commitee and International Framework for liquidity risk measurement, standards and monitoring.
July 2010	"Countercyclical buffer proposal" – Consultative document.
July 2010	"The Group of Governors and Heads of Supervision reach broad agreement on Basel Commitee capital and liquidity reform package".
August 2010	"Basel Commitee proposal to ensure the loss absorbency of regulatory capital at the point of non viability".
Setember 2010	"Group of Governors and Heads of Supervision annonces Higher global minimum capital standards".
October 2010	"Report to G20 on response to the financial crisis released by BCS".
December 2009	"Basel III: A global regulatory framework for more resilient banks and banking systems" and 'International framework for liquidity risk measurement, standars and monitoring".

Basel III Schedule



Impacts

Core Capital

- Changes in level I and II rules
- Minimum values for level I, principal capital and PR

Counterpart Credit Risk (CCR)

- Changes in the calculation methodologies, including standard approaches and use of internal models (IRB).
- Adaptation of the CVA – credit valuation adjustment.
- Reduced trust in external ratings.

Capital Buffer

- Conservation capital to increase the ability to absorb the losses of financial institutions beyond the minimum required in favorable periods of the economic cycle so that the increased capital can be used in times of stress.
- Counter-cyclical capital to ensure that the capital maintained by the financial institutions considers the risk resulting from changes in the macroeconomic environment.

Degree of leveraging

- Implementation of the Level I / Total exposure ratio, with a planned minimum of 3%.

Liquidity measures

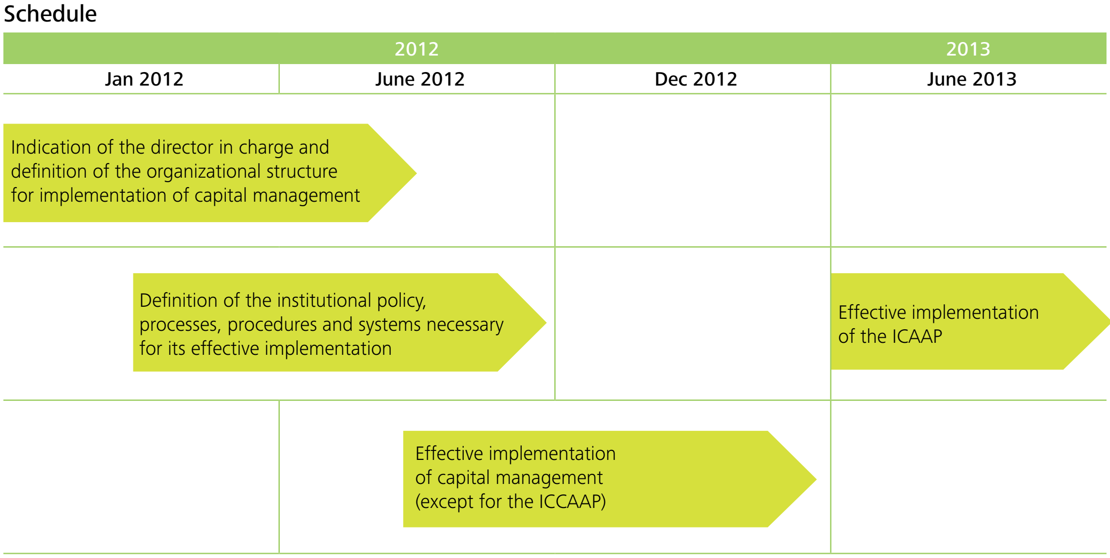
- Introduction of two liquidity indexes:
  - LCR – "liquidity coverage ratio" (short term)
  - NSFR – "net stable funding ratio" (long term)

Internal Capital Adequacy Assessment Process (Central Bank of Brazil Resolution nº 3,988)

The Central Bank of Brazil published Resolution 3,988 with rules on the implementation of a capital management structure. According to this resolution, financial institutions and other institutions authorized to operate by the Central Bank of Brazil required to calculate the Required Reference Equity (PRE) should implement a capital management structure compatible with the nature of their operations, the complexity of the products and services offered and the dimension of their risk exposure, which involves:

- Monitoring and control of the capital held by the institution;
- Evaluation of the needs for capital to deal with the risks the institution is subject to;
- Planning of capital goals and needs considering the strategic objectives of the institution;
- Adoption of a prospective posture, anticipating the capital needs resulting from possible changing in market conditions and the Internal Capital Adequacy Assessment Process (ICAAP). This scope is applicable to entities that:
- Have total assets greater than R$100 billion.
- Have been authorized to use internal models.
- Be part of a financial conglomerate with total assets greater than R$100 billion composed of at least one bank.

Schedule



Solvency II

Effects on the Brazilian insurance market – Even though Solvency II is not regulated in Brazil, there is a tendency that this issue will atract more and more attention in the country. The minimum capital and solvency margin are determined by the National Council of Private Insurance (CNSP). The criteria established by CNSP take into account the magnitude of the operations, when they make reference to premiums issued, the experience on payment of claims and credit risk involving assets. Limitations: not taken into account the quality of the subscribed risk, the quality of the re-insurance contracted, market risks involving assets that guarantee the reserves, the reserve constitution risks, nor other business operating and legal risks.

Corporative governance

Law nº 10,303 entered into effect in March 2002, with the goal of improving minority shareholders' rights, promoting stronger corporate governance and improving disclosure rules. The Securities and Exchanges Commission (CVM) published its own set of voluntary recommendations on corporate-governance practices in June 2002.

The Law alters Law 6,385, of 1976, which created the CVM and continues to regulate it. The CVM remains responsible for monitoring publicly held companies and issuing regulations concerning the type and frequency of information that they must make public – including management reports, financial statements, accounting standards, independent audit reports and minutes of meetings.

Solvency – Regulatory impacts on the Brazilian insurance

RBC/ Solvency	Workgroup (IBA, IBRACON, IRB and FENASEG) discuss a risk-based capital model.
Sarbanes Oxley (SOX)	Brazilian companies that trade stocks or ADRs in U.S. stock markets need to adjust.
SUSEP	Has been strongly acting for the creation of a new normative structure that regulates aspects as internal controls and criteria for capital allocation, for example: • Circular 249/04 – Internal Control Systems • Circular 342/07 – Risk Questionnaire • Circular 344/07 – Fraud Risk – Prevention • Circular 390/08 – Money Laundry Prevention • Resolutions CNSP 158/06, 227/10 e 228/10

New regulations

From the new publications, the following points are worth to be highlighted:

Resolution 227/10	• Provides on determination for the minimum capital required to operate and other provisions. • Defines in which situation the Solvency Correction Plan must be submitted to SUSEP and determines when the Solvency Recovery Plan must be submitted.
Resolution 228/10	• Provides on the rules for additional capital with basis on Insurance and Reinsurance company credit risks.
Resolution 158/06 changed by Circular SUSEP 411/10	• Provides on the rules for additional capital with basis on insurance company subscription risks and other provisions.

The legislation provides for fines and other punishments related to "crimes against the capital markets" that fall under the jurisdiction of the CVM. It states that market manipulation through engagement in fraudulent transactions may result in jail time of 1-8 years, and fines of up to three times the amount of the undue advantage gained by engaging in the fraudulent activity. The misuse of privileged information can result in imprisonment of 1.5 years and fines of up to three times the amount of the undue advantage.

The law also establishes that the CVM may enter into agreements with similar entities in other countries, or with international entities, for assistance and co-operation in investigations of market manipulation both in Brazil and abroad.

The legislation requires that preferred stock holders (those without voting rights but with priority for dividend payments) receive dividends at least equal to common stock holders (those with voting rights). It also establishes that the number of preferred shares without oting rights, or subject to restriction on voting rights, may not exceed 50% of all issued shares.

The CVM's recommendations on corporate governance are not mandatory, and non-compliance is not subject to punishment. However, the commission hopes that companies will indicate their level of adherence and the reasons for noncompliance, if that is the case, in their annual filings.

According to the standards, a company should release quarterly management reports. General shareholders' meetings should take place at times that facilitate attendance. All relevant issues suggested by minority shareholders should be included in the agenda, and notices for the meetings should contain accurate and complete information about topics to be discussed. If a company has foreign depositary receipts programmes, such as American Depositary Receipts (ADRs) or Global Depositary Receipts (GDRs), meetings should be called at least 40 days in advance.

A board of directors is charged with protecting the company's assets, ensuring the attainment of corporate objectives and guiding management towards maximum returns on investments. It should have 5-9 technically qualified members, two of whom should have financial expertise and be responsible for examining accounting practices. An audit committee, comprised of members of the board of directors with experience in finance and including at least one board member representing minority shareholders, should supervise audits to ensure their independence from the firm. The board of directors should prohibit or restrict hiring of the company's auditor for other services that may present conflicts of interest.

All board members should have a one-year mandate with the possibility for re-election, and as many members as possible should be independent of the company's management. Preferred shareholders should be allowed to elect a representative to the board. Company by laws should specify that if dividends are not paid for three years, all non-voting shares will acquire the right to vote. Disagreements between the company and its shareholders should be resolved via arbitration.

The board should evaluate the performance of the chief executive officer annually. It should also ensure that transactions between related parties are clearly reflected in financial statements. Service contracts and loan agreements between related parties should not be allowed.

The CVM also recommends that investors interested in purchasing a controlling share of a company should offer the same price for the controlling group of shares to all other shares.

How financial institutions are taxed in Brazil

Here is a snapshot of tax in Brazil to help those who work in the tax department of a global bank which may be thinking of investing in Brazil:

CIT

Corporate tax

Corporate income tax (IRPJ) is levied on the taxable profits of an entity at a rate of 15%. Financial Sector Institutions (FSI) and other companies pay tax on worldwide income; non-resident companies pay tax only on Brazilian-source income. A financial institution is resident in Brazil if it is incorporated in Brazil. In addition to corporate income tax (IRPJ), financial institutions are subject to income surtax at a flat rate of 10% on profits of more than R$240,000 annually. The government imposes a social contribution on net profits (CSLL) at a rate of 15% (9% to non-financial institutions). This brings the nominal rate to 40% to financial institutions and insurance companies.

Capital gains

Capital gains of banks and other companies are treated as ordinary income, subject to restrictions on offsetting capital losses against ordinary income. Capital gains realized by nonresidents on investments registered with the Central Bank of Brazil are subject to a 15% withholding tax. If the capital gains are derived by a tax haven resident, the rate is increased to 25%.

Losses

Losses must be segregated as "operational" or "non-operational". Non-operational losses may be set off only against non-operational gains. Tax losses incurred in one fiscal year may be carried forward indefinitely, but the amount of the carryforward is limited to 30% of taxable income in each carryforward year. Carryback of losses is not allowed.

Foreign tax credit

A foreign tax credit for qualifying foreign taxes paid is available to offset (up to) the domestic tax (IRPJ and CSLL) imposed on foreign-source income. Further limitations on the credit include a per-company limitation for foreign subsidiaries (some consolidation of branches and of lower tier subsidiaries is allowed) and a per-country limitation for foreign branches.

Incentives

R&D projects and information technology qualify for some direct assistance and tax relief. Under a recent expansion of R&D incentives, exclusion is allowed from the corporate income tax base of 60% to 100% of R&D project expenses. There are some tax incentives that allow an extra deduction of corporate income tax for employee meal programs and donations. Projects seeking fiscal incentives need approval from the relevant agencies.

Transfer Pricing

Brazil's transfer pricing rules only apply to cross-border transactions between related parties and transactions with entities located in tax haven jurisdictions. The rules deviate substantially from the OECD Transfer Pricing Guidelines; they do not adopt the arm's length principle, but rather use fixed margins to calculate the transfer price. Additionally, transfer pricing rules require a cross-border loan agreement to be registered with the central bank for interest to be fully tax deductible. Otherwise, interest is deductible up to LIBOR plus 3%.

Thin Capitalisation

Under the thin capitalization rules, interest paid to related parties or residents located in tax haven jurisdiction or that benefit from a preferential tax regime (PTR) may be deducted on an accruals basis for corporate income tax purposes only (i) if the expenses are necessary for the company's activities, and (ii) both of the following thresholds are met: (a) the related party debt-to-equity ratio does not exceed 2:1 calculated based on the proportion of related party debt to direct equity investment made by related parties (30% for tax haven and PTR); and (b) the overall debt-to-equity ratio does not exceed 2:1 based on the proportion of total debt to total direct equity investment made by related parties (30% for tax haven and PTR).

Any excess interest will be treated as a nondeductible expense for IRPJ and CSLL purposes. The transfer pricing rules affecting cross-border loans (agreements registered with the central bank or Libor plus 3% spread) remain in effect, as do the general requirements for deductibility.

Turnover and other indirect taxes

Profit Participation contribution (PIS) and Social Security financing contribution (COFINS)

PIS and COFINS are federal taxes imposed monthly on gross revenue earned by legal entities. For financial institutions rates are 0.65% and 4%, respectively. Specific deductions are allowed for banks and insurance companies.

Municipal Service Tax (ISS)

Tax on services is a Municipal tax and is imposed on the supply of a list of services set forth in Brazilian legislation. The taxable basis of ISS is the price of the service rendered. ISS is generally levied by the municipality in which the company is established. ISS rates vary from 2% to 5% depending on the municipality and the type of service.

Tax on financial operations (IOF)

The IOF applies to various types of transactions, including loans, foreign exchange conversion, insurance policies and securities. The rate varies from 0% to 25% depending on the operation. IOF is considered as an instrument for economic policy, therefore, its rate can be changed by Brazilian authorities in a short notice.

Withholding tax

Dividends

Dividends are tax free.

Interested on capital

Interest paid to nonresidents is generally subject to a 15% withholding tax (25% for tax haven beneficiaries).

Portfolio Investments

Nonresident investment in the Brazilian financial and capital market is regulated by National Monetary Council. Nonresident investors may invest in the same financial products available to Brazilian investors. To invest in Brazil, a nonresident investor needs to name a representative that will be responsible for providing information and deal with the required registration with the Central Bank and with the Securities and Exchange Commission (CVM). Tax rates vary from 0% to 25% depending on the type and tenure of the investment. IOF tax may apply on foreign exchange and securities transactions. Local banks are exempt of withholding taxes related to investments in financial and capital market.

Royalties

The general withholding tax rate on royalty payments and technical service and technical assistance fees, administrative assistance and similar payments to nonresidents is 15%. Payments for technical services that do not involve the transfer of technology are subject to a 25% or 15% withholding tax. Thus, even though technical services are included within the scope of royalties, the tax authorities may charge a 25% rate, if not specifically addressed in a tax agreement. The Contribution for the Intervention in the Economic Domain (CIDE) also is imposed at a rate of 10% (CIDE was abolished with respect to software payments as from January 1st, 2006).

Administration and compliance

The taxable year in Brazil is the calendar year. Legal entities are charged corporate income tax on a quarterly basis. They may choose to be assessed annually and subject to monthly advance payments, based on an estimate of liability according to a percentage of monthly turnover which is 16% for financial institutions. Excess tax paid is available to offset future taxes. Every business entity in Brazil (including corporations, partnerships, branches and agencies of companies domiciled abroad) must file an annual income tax return for the previous calendar year by the last working day of June. Late payment of IRPJ and CSLL is subject to penalties and interest.

Additional tax information	
Tax treaties	Brazil concluded more than 30 tax treaties
Revenue protection	In addition to transfer-pricing rules, controlled foreign companies (CFC) and general anti-abuse legislation applies
Group	There is no provision for group taxation
Tax Authorities	Brazilian Revenue Service
Other main taxes	Real estate property tax, Rural property tax, Inheritance tax, Federal/Estate VAT, Social taxes on imports, Vehicle property tax, Social Security tax

Technology requirements

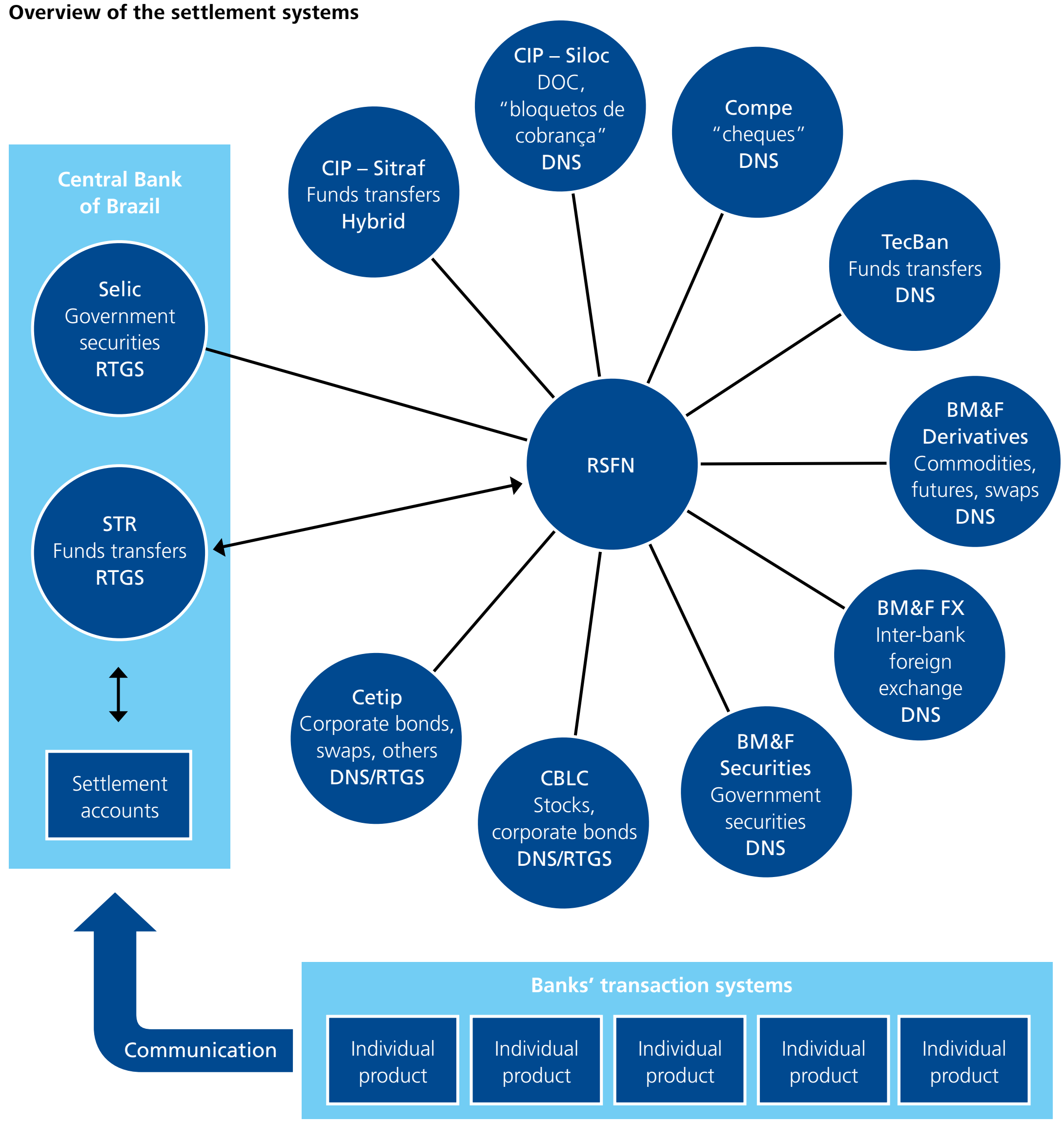
The local financial network

Banks must be linked to the RSFN (Rede do Sistema Financeiro Nacional – National Financial System Network) in order to manage and operate settlements in all clearings in all modes (RTGS and DNS).

Typical bank processing systems are product-driven, creating a broad range of processors that must be linked to RSFN. The typical bank setup builds access to clearings for each individual processor generating an array of connections that requires dedicated personnel and resources.

Market experience shows that a unique access point to the RSFN within the bank's structure, where all processors are connected and which transactions go through would be the best solution. This solution can be built within the bank or use third-party solutions.

Overview of the settlement systems



How to establish a financial institution in Brazil

According to the Brazilian law (National Monetary Council Resolution 3,040 and Circular 3,317), the business plan that Brazilian and foreign applicants need to develop, in order to operate in the domestic financial system, must met certain conditions, such as:

Resolution 3,040

- Market analysis, describing in what market segments the financial institution will be focusing on;
- SWOT Analysis;
- Definition of main products and services to be provided and public targeted;
- Strategic goals;
- Capital structure to be adopted by the financial institution, indicating the source of funds and assets/liabilities evolution over time;
- Definition of corporate governance patterns, such as remuneration and incentives policies;
- Description of the main procedures for controlling risks associated with the financial institution's operations, such as operational risk, credit risk and market risk;
- Internal and external auditing procedures and specifications;
- Organizational structure, clearly indicating the responsibilities and attributions of each organizational level;
- Description of the criteria to be utilized for selecting top management;
- Specification of the information technology infrastructure;
- A detailed economic and financial feasibility analysis report;
- Describe the main premises used in the business plan (e.g.: growth rate, customers income, interest rate);
- Definition of the time frame needed to initiate activities after authorization.

Circular 3,317

- Amount of foreign participation in the total capital of a local subsidiary of a financial institution (not applicable to branches);
- Importance of the entrepreneurship for the Brazilian economy, listing all benefits that could be gathered by the local financial system, such as new technologies, greater variety of products and services, incrementing competitiveness and so on;
- Detailed description of existing activities of the foreign investor in the Brazilian financial system, including any participation in local economic groups;
- Relevance of the local operations to the strategic plans of the foreign investor, including added-value analysis on any existing operations in Brazil;
- Risk rating classification of the applicant, including the entire economic group, if applicable;
- Indication of any financial institutions that maintain direct or indirect relations with the financial institution domiciled abroad;
- Indication of regulatory bodies that supervise the financial institution domiciled abroad, if applicable;
- Other information considered relevant for the analysis by the Brazilian government on the issue.

The steps to establish a bank in Brazil

	Business Plan Elaboration	Business Plan Evaluation by Central Bank of Brazil	BC's Authorization to start the Financial Institution	BC's Authorization to Operate as a Financial Institution	Post Authorization Process and Operations Start up	BC Audit
Phase description/ objectives	Elaborate a business plan, according to the Brazilian law (Resolution 3,040), to be submitted to BC	In this phase, the Central Bank evaluates the reasonability of the business plan. And can request additional information in some cases	Based on all the documents provided, the Central Bank will grant the initial authorization to start the Financial Institution	After the project is approved, the Financial Institution needs to be created (from a legal perspective). This is supported by the Presidential Decree	After the formal authorization to Operate is granted, the Financial Institution needs to be built as per Resolution 3,040 document submitted	Once the bank is up and running the Central Bank will keep track of the bank's performance through the Annual Reports filled by external audit & Spot Audits

06 to 24 months to start operation in Brazil.

Deloitte's global, national, regional and local structure is based on multidisciplinary business areas, service lines and industry-expertise. Contact our professionals in Brazil.

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