



➤ 4th ANNUAL VC SUMMIT

**Does the regulatory environment
support a competitive position?**

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Belo Horizonte, April 2006*

Background on ABVCAP

- Founded in the year 2000 as a membership organization to promote the private equity / venture capital (“PE/VC”) activity in Brazil
 - Members include PE/VC fund managers, institutional investors, capital markets agents, financial institutions, and a recently formed segment for investee companies
 - ABVCAP’s main priorities:
 - **Maximize long term funding –both local and international- to foster entrepreneurship and long term investments in Brazil**
 - **Establish connections with other markets regarding PE/VC practices**
 - **Enhance the link between private enterprises and capital markets**
 - **Disseminate the PE/VC activity among policy and opinion makers**
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Agenda

- **A summary on the regulatory framework for Private Equity & Venture Capital in Brazil**
- **Is it really important to regulate the VC practice?**
 - Regulation as an implementation tool rather than a restricting framework
- **LAVCA, ABVCAP, EMPEA, NVCA, EVCA - the importance of a collaborative environment in Latin America and beyond**

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Building blocks (recent developments)

- **Institutional Investors**

- Pension funds to allocate up to 20% to VC/PE (2002)

- **CVM (local equivalent to the SEC)**

- VC funds (1994); PE funds (2003)

- **Receita Federal (Tax Authority)**

- ‘Official’ recognition of PE/VC capital gains calculation as a closed end fund concept (2006)
- 15% (from 22%) taxation on capital gains to non-exempt local investors (2006)
- Exemption to foreign investors that are not based in tax free jurisdictions (2006)

Other relevant improvements

- **Innovation law (2005)**
 - VC deal flow to be enhanced
- **Minority shareholders' protection**
 - New corporate law (2001)
 - Arbitration (2002)
 - Bankruptcy law (2005)
- **Capital Markets and corporate governance**
 - Novo Mercado (2002); Bovespa Mais (2005)
 - IBGC programs

A summary by CVM: VC/PE as a concrete element in the capital markets map

ASSET CLASSES		IRR	REGULATION
	VENTURE CAPITAL	35+	Instr. 209/2005 Instr. 391/2003 Innovation Law/2005
	DISTRESSED ASSETS	30	Instr. 391/2003 Bnakrupcy Law/2005
	PRIVATE EQUITY; BUYOUTS	25	Inst. 391/2003
	MEZZANINE	20	Instr. 391/2003
	EQUITIES	20	Novo Mercado Instr. 359/2002
	ASSET BACKED SECURITIES	12	Dec. 11.076/2004 (Agri) Dec. 9.514/1997 (CRI) Instr. 393/2003
	CORPORATE BONDS	12	Instr. 400/2003 Instr. 404/2004
	TREASURY BONDS	8	Instr. 409/2004 Andima Benchmarks/2006

} VC/PE

- Source: CVM
- Indicative IRRs only as an informal reference



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An informal assessment: the nature of VC as an “unregulated activity”

- **Global PE/VC market: US\$ 750 billion**
 - US\$ 550 bn in US, EU funds (existing portfolios + dry powder)
 - Balance in direct investments (pension funds, insurance companies, etc.) and incidental allocation (hedge funds and others)
- **How much of this capital is invested under a PE/VC regulation?**
 - Less than 5%, through few listed investment vehicles
- **Is there a correlation between ‘regulation’ and ‘good performance’, ‘well functioning’?**
 - No! Best records in the industry are not from regulated environments.

Possible arguments for regulating Venture Capital

- **Roots of law** (summarized by a non-specialized practitioner)
 - Anglo-Saxon, contractual behavior; standards ‘implemented’ through market practices (US and UK)

Versus

 - Roman, predefined guidelines (Brazil, others)
- **Regulation as a mean of implementation**
 - Facilitating the entrance of institutional investors
 - Disseminating practices through ‘educative’ regulation

Possible risks of regulating the VC activity

- **Lack of flexibility: even in mature markets, GP-LP relationship is defined on a case-by-case basis**
- **Small distortions of any regulation may force ‘permanent’ mistakes in the funds’ governance**
- **SEC’s are not well equipped to oversee the dynamics of a PE/VC fund (and will never be), although in most cases their attitude has been positive so far**

Implementing VC platforms in emerging economies

- **Usual set of restrictions in the initial cycles**
 - The long path to minimum scale of PE/VC funds
 - The (un)stable balance between local and international sources of funding
 - Functioning debt markets to balance the capital structure
 - Local small-cap stock market to allow continued flows

- **In some (most?) emerging countries, implementing a local VC platform requires a regulatory framework for the activity to allow meaningful capital flows**

Conclusion

- **Apart from the implementation steps and from the ‘educative’ role of regulation, ...**
 - ... PE/VC should not be a regulated activity**
 - **Most important regulatory framework is not directly related to the funds’ activity**
 - Regulation for institutional investors’ allocation
 - (US in late 70s; Brazil in 2002)
 - General capital markets (debt and equity) rules
 - General ‘doing business in ...’ requirements
 - Labor laws; taxation; bankruptcy, etc.
 - Efficient legal system; arbitration
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The evolution of PE/VC in this decade calls for a global industry

- **Compatible investment environments, with proper regulatory framework, best practices, IRRs**
- **PE/VC is a relatively new phenomenon**
 - Small scale even in the US until the 80s
- **After increasing in size and importance through the 90s the ‘PE/VC game’ started to travel more consistently**
 - Giant buy-out funds to operate globally
 - US, European VC expanding to new frontiers
 - India, China, Eastern Europe, Latin America (!!!)

A silent requirement from global investors

- **Interest in the proper implementation of PE/VC platforms is no longer a problem for each individual country**
 - Best managers to expand internationally
 - Best practices to provide good returns
 - Well known benefits of PE/VC to gain a global perspective as a consequence
 - Wealth creation, jobs, capital markets
 - **VC Associations to increase their effectiveness through closer collaboration**
 - LAVCA, ABVCAP, EMPEA, NVCA, EVCA
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Venture Capital is in the soul of successful economies.

Each country should develop its own platform to achieve a functioning VC system.

John Snow

**Secretary of Treasury of the United States,
during his meeting with ABVCAP Members
Brasilia, August 2005**



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