

BRAZILIAN CREDIT RIGHTS

*“ Brazilian internal debt...
.....at very high spreads over SELIC”*



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Brazilian Credit Rights

Introduction

Underlying Description

In this presentation we would like to introduce an investment opportunity related to Brazil. In particular, we will discuss about credit rights issued by the Brazilian Federation, the State of São Paulo and their public entities/companies. These credits represent senior debts which have been originated from an irrevocable sentence of last instance with no further options to appeal.

The credit rights stem from judicial proceedings against the Brazilian Federation, the São Paulo and their public entities/companies.

We focus on a particular type of credits called “**Precatòrios**”. They can be grouped into two main categories: **alimony precatòrios** (mainly public employees credits against governmental authorities and/or public companies) and **non-alimony precatòrios** (non public employees credits against governmental authorities and/or public companies). These credits can be enforced with a court order by their respective owners against the public debtors. Until the sentence does not become enforceable and irrevocable, the government/public entity can avoid payment and finance its debt.

These type of credit rights benefit from Federal constitution protection. In fact, the article 100 of the Brazilian Federal constitution regulates the repayments of precatòrios.

Risk/Return Proposition

These credits have an expected IRR ranging in the region of [25%-30%];

Given the nature of the credit rights, investors bear the following risks: i) Default; ii) Timeliness of payments; iii) Legal risk and changes in the regulatory framework; iv) Liquidity; v) Currency.

The case history is so wide that it is possible to define a standard for payments from governmental authorities or other public entities/companies.

Brazilian Credit Rights

Where the Alpha is coming from

1. **Very specialized market with high barriers to entry:**

Access to this type of credit rights is only possible to law firms with extensive local experience:

- An incorrect legal analysis of the credits would undermine any investment attractiveness: the credit payment depends on the outcome of judicial proceedings. We start the negotiation activity after the irrevocable sentence of last instance and the actual issuance of the credit (legal claim status with the registration in the state budget). A timely reporting of opportunities by law firms, the ability to verify the authenticity of the claims and the knowledge of all the legal steps to enforce the payment of the individual credit are all crucial factors in this market;
- To operate effectively, a law firm dealing with such credits must have: a strong presence in the region (in order to access a large universe of potential credit holders), credibility, reputation, recognized skills and strong bargaining power;
- The typical commission structure of the local law firms makes the sourcing, negotiation and management of such credits unprofitable in absence of significant economies of scale.

2. **Reliable, direct and experienced channels to access this market are key elements to our investment process.** The direct involvement and understanding of all the various phases of the life of a credit are also crucial in the portfolio construction.

3. **Local access only:**

The credit rights market is easily accessible to local players only. We have identified a series of way to make these credits available to foreign investors.

4. **“Non-sophisticated” counterparties and low competition:**

Credits are bought directly from the owners, which are usually non-professional players, via their legal representatives. Professionals such as funds and banks are only focusing on very large credits due to due diligence issues while we can focus on small credits where there is almost not competition.

Brazilian Credit Rights

Distinctive elements

Exclusive Access	We have an agreement with Innocenti Advogados Associados, one of the main expert in precatórios for the State of São Paulo and Brazil;
Competitive Advantage	Very specialized market with high barriers to entry. Institutional players focus mainly on large credits, while we can focus on small credits where there is almost not competition;
Direct Sourcing	Low sourcing costs: credits are bought directly from the owners via their legal representatives, there are no intermediaries;
Constitutional Protection	Art. 100 of the Federal Constitution establishes the payment rules for the precatórios;
Interesting Risk/Return	High returns are mainly due to sourcing activity and market access;
No correlation with markets	The investment is completely decorrelated from any market;
Trasparency	The investor is able to access the due diligence of the credit rights on-line. In addition, payments are published monthly by the relevant tribunal;

Brazilian Credit Rights

High Revaluation Rates

High Revaluation Rates

- Credit Rights are revaluated every year by 6% or 12% as interest on late payments plus the adjustment for inflation (currently roughly 6%) on the notional value of the credit;
- The lawsuit is clearly stating if a credit is going to be revaluated at 6% or 12%.

Example: Real case

- **Credit right:**
 - Nominal value: R\$ 813,530
 - Interest rate: 6%
 - Inflation rate: 6%
 - Purchase price: 40%, i.e. R\$ 325,412
 - Paid after: almost 4 years
- **Repaid value:** R\$ 1,218,265
- **Total return:** 374%
- **IRR:** 39.1%

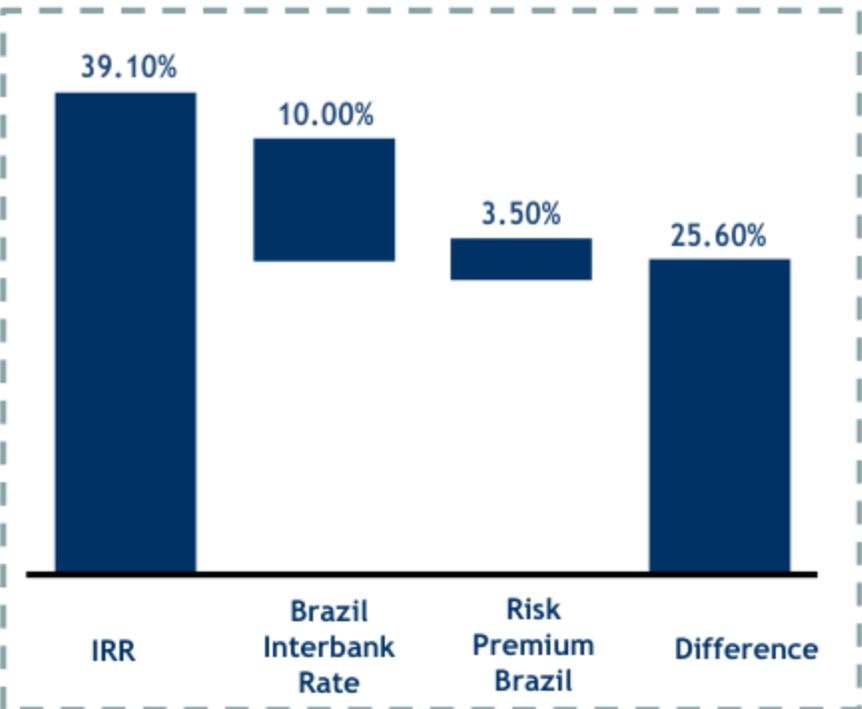


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Overview of the Credit Rights Market

Description

Background

- The precatório market is mainly practiced by specialized law firms involved in lawsuits on behalf of clients which go to them offering their precatórios for a huge discount.
- In recent years, banks, mutual/hedge funds and other companies have identified a series of business opportunities in precatórios, either holding them up to maturity or using them for tax compensation.
- Players focused mainly on Federal Precatórios, but given the attractive return profile, they have also acquired State and Municipal Precatórios (especially from São Paulo)

Main Players

- Local and foreign Banks
- Investment funds (FIDCs, *Fundo de Investimentos em Direitos Creditorios*), including onshore and offshore investors
- Companies using for tax compensation (i.e. VAT and income tax)

Market Size

- It is estimated that the inventory of precatórios in Brazil, including municipal, state and Union debts, is worth US\$ 58 billion*;
- The state of São Paulo has debts in already issued precatórios of approximately US\$ 9 billion, half of them are of alimony nature*.

Focus

- We will only focus on:
 1. Federal Precatórios;
 2. State Precatórios (only issued by the state of São Paulo);
 3. Credit Rights issued by Public Companies.

* Source: IAA.
These data exclude credit rights issued by Public Companies

Overview of the Credit Rights Market

Political Geography of Brazil to Understand Different Types of Precatòrios Issued

- The Brazilian Federation is divided into 26 states (estados) and one federal district (distrito federal), which contains the capital city, Brasília.
- The states are subdivided into 5,564 municipalities (municípios).

Different type of Precatòrios

Federal Precatòrios

States Precatòrios

Federal District
Precatòrios

Municipal
Precatòrios

- All of them can be of alimony or non-alimony nature

Other Types of Credit Rights

Credit Rights issued
by Public
Companies

- These are credits which stem from judicial proceedings against public related companies (sociedade de economia mista)



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Legal Framework: Litigation

Innocenti Advogados Associados

Litigation



Innocenti Advogados Associados originated from a strong expansion of the Professional activities of the former Advocacia Ricardo Innocenti, founded in the early 80's, and that focused on Administrative Law and Labor Relations.

For over 30 years we have been conducting actions for legal entities and individuals, meeting their expectations through the daily efforts of a specialized team of professionals, which is committed to the needs of each client.

This experience has allowed us to acquire the necessary knowledge and feeling to transform legal matters in efficient ethical solutions, suited to each situation. Our attorneys' and advisors' job is not limited to representing our clients' legal interests, but also to offer them a concrete and customized picture of results.

Structure

IAA team consists of approximately 100 professionals.

IAA have attorneys that represent the office in the main Brazilian cities, as well as a legal team based in the Federal District, which allows for better follow-up of our clients' judicial proceedings brought before superior courts.

Marco Antonio Innocenti is currently the president of the Precatorios Commission in Brasilia.

Precatorios Commission



PORTARIA n. 086/2013

Cria a Comissão Especial de Defesa dos Credores Públicos (Precatórios) e designa os membros.

O Presidente do Conselho Federal da Ordem dos Advogados do Brasil, no uso das suas atribuições legais e regulamentares, de acordo com o Provimento n.115/2007,

RESOLVE

criar a Comissão Especial de Defesa dos Credores Públicos (Precatórios) e designar os membros:

- Marco Antonio Innocenti (SP) – Presidente;
- Fernando Carlos Araújo de Paiva (AL) – Vice-Presidente;
- Flavio Jose de Souza Brando (SP) – Secretário;
- André Almeida Garcia (SP);
- Eduardo de Souza Gouveia (RJ);
- Frederico Augusto Alves de Oliveira Valtuille (GO);
- Heitor Magalhães Lopes (RO);
- Ricardo Lobo Cavalcanti de Albuquerque (AL);
- Telmo Ricardo Abrahao Schorr (RS);
- Tiago Staudt Wagner (AP);
- Paulo Henrique Triandafelides Capelotto (SP) – Membro Consultor.

Dê-se ciência e registre-se.

Brasília/DF, 15 de maio de 2013.

Marcus Vinicius Fartado Coelho
Presidente

Legal Framework:

Brazilian Federal Constitution - Art. 100

Payment of Credit Rights

Article 100. Payments owed by the federal, state, Federal District, or municipal treasuries, by virtue of a court decision, shall be made exclusively in chronological order of submission of court orders and charged to the respective credits, it being forbidden to designate cases or persons in the budgetary appropriations and in the additional credits opened for such purpose. (CA No. 20, 1998; CA No. 30, 2000; CA No. 37, 2002; CA No. 62, 2009)

Paragraph 1. Support-related debts include those arising from wages, salaries, pay, pensions, and their supplementations, social security benefits and compensation for death and disability, such compensation being based on civil liability, by virtue of a final and unappealable judicial decision, and shall be paid before any other debts, except those referred to in Paragraph 2 of this article.

Paragraph 2. Support-related debts owed to persons aged 60 (sixty) or over on the date the respective court order is issued, or to persons with serious diseases, as defined by law, shall be paid before any other debts, up to an amount equivalent to three times the amount stipulated by law for the purposes of Paragraph 3 of this article, parceling for such end being permitted, whereas the remaining amount shall be paid according to the chronological order of submission of respective court order.

Paragraph 3. The provision contained in the head paragraph of this article, regarding the issuance of court orders, does not apply to obligations defined by law as small amounts, which must be paid by the treasuries herein referred to by virtue of a final and unappealable court decision.

Paragraph 4. For the purposes of the provision of Paragraph 3, different amounts may be stipulated for the federating units through their own legislation and according to their various economic capabilities, whereas the minimum amount shall be equal to the amount of the highest benefit paid by the general Social Security scheme.

Paragraph 5. It is mandatory for the budgets of the federating units to include the funds required for payment of debts arising from final and unappealable judicial decisions, stated in court orders submitted until or on July 1, and payment shall be made before the close of the subsequent fiscal year, on which date their amounts shall be adjusted for inflation.

Paragraph 6. The budgetary allocations and the credits opened shall be assigned to the Judicial Power, it being within the competence of the Presiding Judge of the Court which rendered the decision of execution to determine full payment and to authorize – upon petition of a creditor and exclusively in the event that his right of precedence is not respected or that the amount necessary to satisfy the debt has not been set aside – attachment of the respective amount.

Paragraph 7. The Presiding Judge of the appropriate Court who, by means of an act or omission, delays or attempts to frustrate the regular payment of a court-ordered debt shall be liable to crime of malversation and shall also appear before the National Council of Justice.

Paragraph 8. The issuance of a court order as a supplementation to or in addition to an amount already paid, as well as the parceling, apportionment, or reduction of

the amount under execution – so that the provision of Paragraph 3 may be applied to a portion of the total amount – are forbidden.

Paragraph 9. At the time a court order is issued, irrespective of the relevant regulation, there shall be deducted from such court order, for the purpose of a set-off, an amount corresponding to clear legal debts, either registered or not under debts in execution and attributed to the original creditor by the Treasury in debt, including future accruing installments of parcelings, save for those whose execution has been stayed by virtue of administrative or judicial challenge.

Paragraph 10. Before a court order is issued, the relevant court shall request that the Treasury in debt must provide, within 30 (thirty) days, otherwise subject to loss of the right to offset, information on the debts which meet the conditions stipulated in Paragraph 9, for the purposes set forth in said Paragraph.

Paragraph 11. In accordance with legislation of the federating unit in debt, a creditor may employ court order credits to purchase public property belonging to the respective federating unit.

Paragraph 12. As from the date Constitutional Amendment no. 62 is enacted, the amounts stated in court orders, after such court orders are issued up until effective payment, irrespective of their nature, shall be adjusted according to the official rate applied to savings accounts, whereas, for the purpose of compensation of delay in the payment, simple interest will be applied at the same percentage of interest applied to savings accounts, the employment of compensatory interest being excluded.

Paragraph 13. Creditors may assign their court order credits, in whole or in part, to third parties, irrespective of consent by the debtor, and the provisions of Paragraphs 2 and 3 shall not be applied to the assignee.

Paragraph 14. Assignment of court order credits shall only produce effects after communication to the court of origin and to the federating unit in debt by filing a relevant petition.

Paragraph 15. Without prejudice to the provisions of this article, a supplementary law to this Federal Constitution may establish a special regime for the payment of court-ordered debts owed by States, the Federal District, and Municipalities, providing for earmarked net current revenues and for payment term and methods.

Paragraph 16. The Federal Government may, at its own discretion and under the terms of relevant law, take on debts resulting from court orders issued against a State, the Federal District, or a Municipality, and refinance them directly.



Legal Framework

Illustration of Precatório Timeline

Theoretical Sequence in a Lawsuit Resulting in the Issuance of a Precatório



Single installment for both Alimony and Non-Alimony *precatórios* as a result of the EC n.62/2009*

(1) *precatórios* issued until June 30 of a determined year (y) must be paid until December 31 of the following year (y+1). *precatórios* issued in the second semester of a determined year must be paid until December 31 of the year following the subsequent year (y+2).

* Non-Alimony federal *precatórios* are still paid in instalments

Legal Framework

Main Changes Introduced by Constitutional Amendment n.62/2009*

Main changes and characteristics of the new regime

- **Effectiveness:** Immediate effectiveness, encompassing all outstanding precatòrios and derived lawsuits
- **Special Regimes:** States and municipalities have 2 alternatives to pay precatòrios debts (“Special Regimes”):
 - (A) Mandatory annual deposits of amounts equivalent to certain fixed percentages of current revenues
 - (B) Linear yearly amortizations in order to zero the inventory in up to 15 years
- **Chronological order:** At least 50% of precatòrios shall still be paid according to chronological order of issuance (within each year alimony precatòrios have priority over the non-alimony ones)
- **Auction:** Residual 50% shall be paid using an auction mechanism (3 options are available to Public Debtors)
- **1st Priority:** Alimony precatòrios for holders with at least 60 years old or which are seriously ill (in some specific cases established by law), regardless of the year of issuance, will have first priority over any other precatòrio up to a value established by law.
- **Instalments:** following Constitutional Amendment n.62/2009 the non-alimony precatòrios, except for the federal ones, will not be paid in instalments anymore, but with a bullet payment as per alimony precatòrios
- **Seizure remedy:** Seizure route limited to breach of mandatory payments established in (A) or (B), but the President of the Court which causes delay to the regular payment of precatòrios can incur in criminal responsibility.
- **Discretionary Union refinancing:** The Union, at its sole discretion, can decide to refinance precatòrios of other public entities;
- **Tax compensation:** Possibility of tax compensation for precatòrio holders
- **Adjustment Rates:** Precatòrios, including the federal ones, shall be adjusted by official rates applicable over savings deposit accounts, as opposed to inflation rates + interest rates, which were previously in force
- **Incentive to avoid insolvency:** as long as Public Debtor is in the default, the entity a) may not contract a foreign or domestic loan; b) cannot receive voluntary transfers;
- **Fungibility with Public Real Estate:** following EC n.62/2009, creditors have the possibility to purchase public properties using precatòrios of same public entity

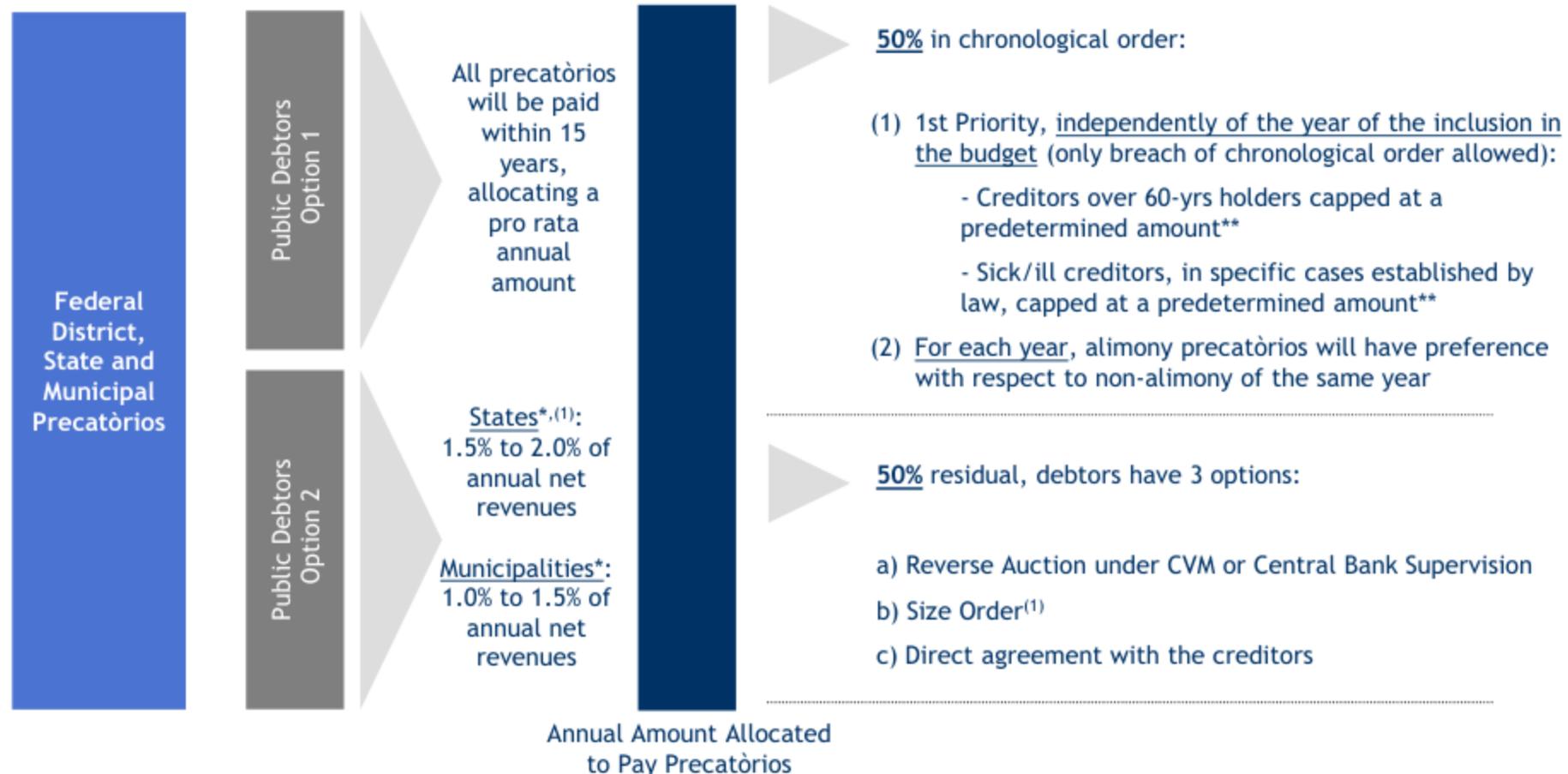
*Amendment No. 62, of 9 December 2009, which modify art. n.100 of the Federal Constitution and art. 97 of the Transitory Constitutional Provisions Act

Legal Framework

Payment Mechanism for Precatórios following EC n.62/2009

Federal Precatórios

- In principle, federal precatórios are not affected by EC n.62/2009, so they will still be paid in installments; they will follow chronological order with no annual budget limit and without any priority or exception;
- Only the interest rates calculations have been affected; from 2011 they shall be adjusted by official rates applicable over savings deposit accounts, as opposed to inflation rates + interest rates, which were previously in force;



* According to the geographical location of the state or municipality

** Each state can choose a threshold

(1) The State of São Paulo has adopted this regime (link: <http://www.tj.sp.gov.br/Depre/Pagamentos/Estaduais/Default.aspx>)

Legal Framework: Latest News

Declarations of unconstitutionality

Federal Supreme Court

In 2013 the Emenda Constitucional EC 62/2009 has been declared unconstitutional

The screenshot shows the website of the Supremo Tribunal Federal (STF) of Brazil. The header includes the text 'ESPAÇO DO SERVIDOR | ENGLISH | ESPAÑOL' and 'MAPA DO PORTAL'. The main navigation bar contains links for 'PRINCIPAL', 'SOBRE O STF', 'ESTATÍSTICA', 'PROCESSOS', 'JURISPRUDÊNCIA', 'PUBLICAÇÕES', 'BIBLIOTECA', 'IMPRESSA', 'LEGISLAÇÃO', and 'ACESSO À INFORMAÇÃO'. The page is displaying a news article under the 'Imprensa > Notícias STF' section. The article title is 'STF julga parcialmente inconstitucional emenda dos precatórios' and is dated 'Quinta-feira, 14 de março de 2013'. The article text discusses the STF's decision on the unconstitutionality of parts of Emenda Constitucional 62/2009, which established a special regime for the payment of precatórios (debts).

■ Two are the main changes that have been declared unconstitutional:

▶ The credit rights market has be fully repaid in 15 years;

▶ The revaluation of the credit rights has to be done at savings deposit accounts rather than 6% or 12% plus inflation;

What happened as a result of the Declarations of unconstitutionality?

- Credit rights are now revaluated again at 6% or 12% plus inflation;
- In order to repay the full stock of credits the president of the precatórios commission, Marco Antonio Innocenti and the government minister Luiz Fux are discussing the possibility of a “Modulação”, i.e. how to repay the credits within a maximum of 5 years.

Legal Framework: Latest News

Press Article: “Modulação”

“Modulação”

Ministro do STF Luiz Fux propõe que precatórios sejam pagos até 2018

- A dívida dos Estados e municípios com precatórios deve ser paga até 2018, conforme proposta apresentada pelo ministro Luiz Fux, nesta quinta-feira. Em breve, o Supremo Tribunal Federal (STF) terá de decidir como os débitos, que somam cerca de R\$ 90 bilhões, serão pagos.
- Em março 2013, a Corte considerou inconstitucional a emenda que permitia o parcelamento dos precatórios em até 15 anos e previa a realização de leilões de títulos.
- Em 25 março 2015, o Supremo Tribunal Federal (STF) decidiu que Estados e municípios devem quitar seu estoque de precatórios até o fim de 2020.

Link:

[precatórios-ate-2020-decide-stf.shtml](#)

Legal Framework: Latest News

“Estados e municípios devem quitar precatórios até 2020, decide STF”

Ministro do STF Luiz Fux propõe que precatórios sejam pagos até 2018

O STF (Supremo Tribunal Federal) decidiu nesta quarta-feira (25) que Estados e municípios devem quitar seu estoque de precatórios –dívidas do poder público reconhecidas pela Justiça– até o fim de 2020. A estimativa do CNJ (Conselho Nacional de Justiça) é que o montante esteja na casa dos R\$ 94 bilhões.



O tema estava sendo discutido pelo Supremo desde 2013, quando a corte derrubou uma emenda constitucional de 2009 que instituía um sistema de parcelamento dos pagamentos em até 15 anos.

A legislação ainda fixava a TR (Taxa Referencial) como índice para a correção dos títulos e abria a possibilidade dos chamados leilões inversos, quando o credor que oferecesse o maior desconto ao Estado teria preferência para o recebimento.

De acordo com a decisão do STF desta quarta, todos os precatórios devem ser quitados até 2020. A partir daí, as dívidas reconhecidas até julho terão de entrar no orçamento do ano seguinte, o que evitaria novo acúmulo de débitos.

Os ministros ainda definiram que, até esta quarta, os títulos serão corrigidos pela TR, mas, a partir desta quinta, passa a valer um índice de preços, o IPCA-E.

Para evitar futuros questionamentos na Justiça, os ministros validaram todos os pagamentos já realizados, inclusive os feitos através de leilões inversos, que passam a ser proibidos. Apesar disso, até 2020 os credores poderão fazer negociações diretas com o Estado para tentar furar a fila de pagamentos, mas o desconto máximo permitido será de 40% sobre o valor da dívida.

A decisão da corte ainda mantém a obrigação de Estados e municípios destinarem o mínimo de 1% a 2% de suas receitas correntes líquidas até 2020 para o pagamento dos precatórios. Aqueles que descumprirem a regra ficam sujeitos a sanções.

Durante o julgamento, o único ministro a se manifestar contrariamente às regras definidas foi Marco Aurélio Mello. De acordo com ele, caberia ao STF somente dizer se a emenda que tratava de precatórios era ou não constitucional, sendo inviável se criar mecanismos para futuros pagamentos, o que só poderia ser feito pelo Legislativo.

"Estamos a substituir o Congresso Nacional. Estamos a reescrever a Constituição Federal (...) quando o STF avança e extravasa limites lança um bumerangue que pode voltar à respectiva testa", disse.

O ministro Gilmar Mendes, por sua vez, ponderou que uma vez derrubada a emenda constitucional, que de uma forma ou de outra havia permitido a retomada do pagamento de precatórios, era preciso que se criassem regras de transição.

"Se só declarássemos a nulidade as consequências também seria desastrosas."

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Structuring

How to Repackage the Credit Rights

Available Vehicles

- In order to invest in these credit rights we can offer two types of vehicles:

Note

- Issued in Luxembourg by a German Issuer with very good reputation;
- Daily valuation;
- Listed on the Frankfurt Stock Exchange;

Fund

- Bahamas Fund with quarterly NAV;
- Audited Fund;

Note - Terms and Conditions



Instrument	Note
Name	7Y USD Enhanced Brazilian Credit Linked Bonds 2014(21)
Issuer	Opus - Chartered Issuances S.A. - Luxembourg
ISIN	DE000A13TYW2
Global Custody	Clearstream Banking AG, Frankfurt
Listing	Frankfurt Stock Exchange (Open Market) with daily quotation
Maturity Date	7 Years
Currency	USD
Minimum Denomination	50'000 USD
Minimum trading amount	250'000 USD
Issue Price	100%
Governing Law	German

Fund - Terms and Conditions



Fund Denomination	Enhanced High Yield Fixed Income Fund
Investment Manager	Prudentia Group Ltd
Administration Agent	Equity Bank And Trust Bahamas Limited
Structure	Lux Open-ended Fund
Investors	Qualified Investors
ISIN Code	BSP3720H1081
Class of Share	USD
Minimum Investment	Euro 125k
Redemption	Quarterly
NAV	Quarterly
Mgmt Fees	1%
Performance Fee	0%

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