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Securitisation of agribusiness financial instruments in Brazil: an expanding market

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Over the past few decades the Brazilian agribusiness industry has undergone significant changes which have turned Brazil into a global leader in the production and exportation of agribusiness products. Apart from its climatic and geographic advantages, Brazil has invested in scientific and technological development and in the modernisation of its agribusiness activities, which has helped to make the country one of the most respected forums for agribusiness industry in the world.

In recent years very few countries have experienced such growth in agribusiness. For example, the crop harvest in Brazil increased from 57.8 million tonnes in 1991 to 132.9 million tonnes in 2007. In the same period, the cattle business also experienced surprising growth, leaping from 2.3 million tonnes in 1991 to 23.4 millions tonnes in 2007, according to the Ministry of Agriculture.

The Brazilian agribusiness industry turned over R564.36 billion (approximately \$324.34 billion) in 2007, an increase of 4.5 per cent on 2006. In 2007 agribusiness accounted for 23.3 per cent of Brazilian gross domestic product and 36.4 per cent of the total Brazilian exports of \$160 billion. Between 2000 and 2007, agribusiness exports more than doubled from \$20.59 billion to \$49.42 billion, according to the Ministry of Agriculture.

The ministry's projections suggest a favourable outlook for the Brazilian agribusiness industry for the next 12 years. Currently, 127 million tonnes of rice, beans, corn, soybean and wheat are produced. According to the ministry's estimates, such production could reach 227.3 million tonnes by 2018 – an increase of 79 per cent.

In order to maintain this projected growth, the ministry estimates that a large amount of funding is required to finance the production and marketing

costs of agribusiness products. For the harvest period of 2005 to 2006, the ministry estimated that financing the agribusiness industry would cost R110 billion (approximately \$63.2 billion). R33 billion (approximately \$18.9 billion) of this would be provided by the National System of Rural Credit, with the remaining R\$77 billion (approximately \$44.2 billion) provided by means of private investments or finance. Although the ministry estimates that the harvest for the next 12 years will increase substantially, it has not provided any financing forecast for this period.

In order to expand the financing alternatives in the agribusiness arena, the Brazilian government enacted Law 11,076/04 on December 31 2004, which introduced new concepts of agricultural policy and created new credit instruments for the agribusiness industry, thus increasing the opportunities for financing of agribusiness activities through the financial and capital markets.

Agribusiness investment instruments

Law 11,076/04 introduced three new finance instruments for agribusiness:

- the *letra de crédito do agronegócio* (LCA);
- the *certificado de direitos creditórios do agronegócio* (CDCA); and
- the *certificado de recebíveis do agronegócio* (CRA).

General characteristics

The agribusiness instruments are freely negotiable nominal credit instruments, representing a cash payment promise, which are backed by receivables originating from trade and financial transactions and carried out between rural producers or their cooperatives and financial institutions, companies engaged in the sale of machinery and agribusiness supplies, and companies involved in the sale, processing or industrialisation of agribusiness products.

The differences between various agribusiness instruments depend on the issuer. LCAs are issued exclusively by financial institutions, CDCAs are issued

exclusively by agribusiness companies and CRAs are issued exclusively by agribusiness credit rights securitisation companies.

The credit rights which may be linked to the issuance of the agribusiness instruments include:

- the *cédula de produto rural*;
- the *certificado de depósito agropecuário* and *warrant agropecuário*;
- the *duplicata mercantil*;
- the *duplicata rural*;
- the *nota promissória rural*;
- the *cédula rural pignoratícia*;
- the *cédula rural pignoratícia e hipotecária*;
- the *cédula rural hipotecária*; and
- the *cédula de crédito bancário* (collectively, the receivables).

The agribusiness instruments may be publicly offered and negotiated in stock exchanges and futures and commodities markets, as well as in regulated over-the-counter markets authorised by the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários* or CVM).

As for tax aspects, transactions involving the issuance of agribusiness instruments are free from financial transactions tax (the IOF), whereas general investment transactions are subject to financial transactions tax at a maximum rate of 1 per cent per day, according to the term of the investment (investments with term superior to 30 days are also not subject to IOF). In addition, profits earned by individuals from agribusiness instruments are also free from income tax.

LCAs

An LCA is an instrument issued exclusively by financial institutions, whether public or private. Before the enactment of Law 11,076/04, financial institutions had to maintain the originated receivables in their portfolio until final maturity, which limited their capacity to generate new finance for rural producers. After the enactment of Law 11,076/04, financial institutions

were allowed to anticipate the return of amounts allocated to transactions by issuing and selling in the financial markets LCAs backed by one or more portions of receivables, thereby increasing their capacity to finance the agribusiness industry.

When an LCA reaches maturity, the financial institution must pay to the holder of the instrument the amount established in that instrument. If it does not pay, the holder may use the receivables backing the LCA or other guarantees agreed on the issuance of the instrument in order to obtain the amounts owed.

CDCAs

As rural producers often obtain finance directly from agribusiness companies – whether by the financed acquisition of supplies and/or machinery or by obtaining financial resources to develop their activities – the legislature created CDCAs, an instrument similar to the LCAs issued by financial institutions.

Before the enactment of Law 11,076/04, agribusiness companies had to maintain the receivables which they originated in their portfolio until final maturity, which limited their capacity to provide new finance to rural producers. Under Law 11,076/04, like financial institutions, agribusiness companies can capitalise themselves on the market, thus anticipating the return of amounts allocated in transactions upon the issuance and sale on the financial markets of CDCAs backed by one or more portions of receivables, increasing their capacity to finance the agribusiness industry.

When CDCAs reach final maturity, the agribusiness company must pay the holder of the instrument the amount indicated in that instrument. In case of non-performance, the holder may use the receivables backing the CDCA and any other collaterals agreed on the issuance of the CDCA to obtain the amount to which it is entitled.

Provisions common to LCAs and CDCAs

In order to make the issuance of LCAs and CDCAs safer, Law 11,076/04 establishes that the receivables linked to such instruments must be registered in a clearing and

settlement systems authorised by the Central Bank of Brazil. Furthermore, the receivables linked to the CDCA must be held in custody by an institution authorised by the CVM to carry on custody services.

In regard to security rights, both LCAs and CDCAs create a pledge on the respective receivables in favour of the investor, independent of express provisions in the instrument to that extent. Therefore, the receivables linked to such instruments may not be seized or arrested in relation to any other debts of the financial institution or of the issuing agribusiness company, as the case may be, except for those represented by the LCAs and CDCAs themselves.

CRAs

The issuance of CRAs is very particular and is conducted exclusively by agribusiness securitisation companies – these are special purpose vehicles incorporated as publicly held companies for the purpose of acquiring and securitising agribusiness instruments.

To issue CRAs, the securitisation company:

- negotiates and acquires the agribusiness credit rights from rural producers, agribusiness companies and financial institutions;
- links such credit rights to a specific series of CRAs by agreeing on a credit rights securitisation instrument; and
- places the series of CRAs with public investors.

On the payment dates of the CRAs, the securitisation company uses the resources arising from the payment of the credit rights linked to the respective series to pay the investors. If such resources are insufficient for the complete payment of the amounts owed to investors, the securitisation company is held responsible for payment of the outstanding balance.

To strengthen investor protection, it is possible to establish a flotation charge over the assets of the securitisation company, which does not prevent the negotiation of the assets. Moreover, securitisation companies may establish a fiduciary regime over one or

more credit rights in their portfolio. In this case, the credit rights subject to the fiduciary regime may be used only for payment of the series of CRAs to which they are linked; they are unaffected by other debts of the securitisation company, even if it becomes bankrupt.

Agribusiness instruments

Apart from the pledge of agribusiness receivables, agribusiness instruments and the supporting receivables may have other security rights that are agreed by the parties upon the issuance of the instrument or origination of the receivable, as the case may be. Such security rights include pledge of crops and/or machinery, mortgage of rural real estate and pledges, and/or fiduciary assignments of other credit rights related to agribusiness.

In order to be binding on third parties – mainly other creditors of the issuer of the instruments or the debtor of the receivables – the security rights must be registered with the competent public notary. In the case of crops, machinery or credit rights, the security rights are usually registered with the Registry of Deeds and Documents of the domicile of the debtor. In the case of rural real estate, the security rights are registered with the Real Estate Registry where the rural real estate is registered.

Moreover, in cases in which the security right is represented by pledge of crop, it is common for the parties to hire a monitoring company to monitor and control the crop from plantation until harvest and delivery of the crop.

Registration of agribusiness instruments with BM&F

Interest in agribusiness instruments has increased significantly in recent years. On December 31 2005, one year after the enactment of Law 11,076/04, the Brazilian Futures and Commodities Exchange (BM&F) registered R29.9 million (approximately \$17.2 million) in issuance of agribusiness instruments. By December 31 2006 this figure had already risen to R172.9 million (approximately \$99.3 million), reaching R452.1

million (approximately \$259.8 million) by December 31 2007. By March 31 2008 issuance of agribusiness instruments amounted to R1.1 billion (approximately \$632.2 million).

These numbers reveal the significant potential of the Brazilian capital market for agribusiness instrument, which is expected to be increasingly exploited by rural producers, agribusiness companies and financial institutions.

Credit rights investment funds

Credit rights investment funds (FIDCs) were created by Instruction 356, issued by the CVM on December 17 2001. A FIDC can be organised as a closed-end or opened-end condominium and has the purpose of investing a significant portion of its net equity in credit rights, pursuant to the investment policy and the concentration limits set forth in its regulation.

The agribusiness activity in Brazil presents strong growth potential for the future and agribusiness instruments will have an important role to play.

As a result of the growth predictions and the constant search for portfolio diversity, financial institutions, portfolio managers and other market participants have structured FIDCs to invest exclusively in agribusiness instruments and receivables.

By issuing different classes of unit (senior, mezzanine and subordinated), the settler of the FIDC may gain access to investors looking for different risk levels. Within such structures, the classes of subordinated units offer an additional level of guaranty to the senior units, absorbing the losses derived from the non-performance of the FIDC portfolio.

Out of the nearly R10 billion (approximately \$5.7 billion) raised by FIDCs in 2007, around R1.5 billion (approximately \$862 million) was destined for the acquisition of agribusiness assets. Such participation is expected to rise in the near future.

Conclusion

Agribusiness instruments are tools of growing importance in the Brazilian financial and capital markets.

They provide a means for rural producers, agribusiness companies and financial institutions to obtain financing at lower costs compared to those offered by other sources, and a safer way for investors to invest in the agribusiness sector. This is mainly because they allow for

the existence of security rights and other mechanisms that minimise the risks of such investment. In addition, there is growing demand for agribusiness instruments in stock exchanges and over-the-counter markets, which affords greater liquidity for such investments.