EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye On The Future

Brazil:
The Carnival of Equipment Financing

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The Foundation accomplishes its mission through development of studies and reports identifying critical issues impacting the industry.

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Equipment Leasing and Finance Foundation

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Preface

US equipment financiers have exhibited an ever increasing interest in the international expansion of their business. Although the established links and business interconnection between the US and Europe naturally represented the US equipment leasing and financing industry's first foray into international expansion, the rapidly growing economies of Brazil, Russia, India, and Brazil (the BRICs) recently have caught the attention of the US industry.

Given this interest, the Equipment Leasing & Finance Foundation has identified the need for significantly better information about the equipment financing industry and practices in Brazil. Leveraging on the success of its White Paper on China, the Equipment Leasing & Finance Foundation has commissioned a White Paper on the Brazilian equipment leasing market. Armed with data regarding the environment, regulatory framework, unique risks, and how others have entered the market, lessors can make more informed decisions as to how, or if, they should pursue this opportunity.

Principals of The Alta Group, from our offices throughout the world, particularly the Latin American Region, participated in the research and analysis for this White Paper. Lessors with experience in Brazil also provided valuable assistance. It is hoped that this information will assist lessors in gaining an important "first-mover" advantage into this rapidly developing market.

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Acknowledgements

The Equipment Leasing & Finance Foundation would like to gratefully acknowledge the assistance, time, and knowledge of the following in the preparation of this report:

- Rafael Cardoso, Chairman , Brazilian Equipment Leasing Association (ABEL)

- Carlos Tafla, Executive Director, Brazilian Equipment Leasing Association (ABEL)

- Arnaldo Pieruccini and Paulo Pagani, Associates The Alta Group, Sao Paulo, Brazil

- Luiz Gastão Leães Filho, partner Leães Advogados, Sao Paulo, Brazil

- Banco Central do Brasil for consultation and provision of relevant information.

In addition, special thanks is due to those ELFA member companies that added to the quality of information in this report by generously giving of their time, experience, and insights. These companies, for business and other reasons, wish to remain anonymous.

Executive Summary

Brazil is a large, growing, attractive market for those in the equipment financing industry. Brazil is home to the world's 11th largest economy, with a 2007 GDP of $1.3 trillion, and it has a vibrant, established leasing and financing industry dating to the mid-1960s. Company equipment financing portfolios totaled US$27.6 billion as of September 2007.

Motor vehicles are, by far, the most commonly leased assets in Brazil, and they account for over 82% of lessors' portfolios. Machinery, equipment and I/T assets comprise most of the rest. Residual value leases are well-established in the motor vehicle leasing market, but are relatively new for most other types of assets. Non-vehicle used equipment markets are not yet well-developed.

Unlike most North American and European countries, equipment financing is highly-regulated in Brazil. The creation of both major types of leasing entities – SAMs (Sociedades de Arrendamento Mercantil) and Banco Multiplos – require approval from the Central Bank. There are a number of important tax and funding regulations that pertain to lessors; for example, minimum paid-in capital is R$7 million (approximately US$4.1 million) for leasing portfolios and R$17.5 million (approximately US$10.3 million) for commercial bank portfolios, but can be much higher depending on variables such as number of branch offices or percent of risk-weighted assets.

Effective risk management for equipment financing activities in Brazil is critical for success. The availability of reliable credit information is a concern, despite the development of a large, private credit agency (Serasa) and the existence of a public credit bureau managed by the Central Bank. That notwithstanding, credit loss experience has been good among existing lessors in Brazil, most of which cite the importance of local knowledge in making informed credit decisions. New market entrants should consider the viability of using local lessors with extensive credit expertise and knowledge of local markets as partners for that purpose. Other risk parameters in Brazil requiring particular attention include currency and interest rate volatility (hedges are available for Banco Multiplos), recourse risk (the court system is inefficient), and regulatory compliance with the Central Bank.

Brazil's work force is highly-educated, but finding employees with meaningful financing experience can be difficult. English skills are reasonably common among top management at larger companies (though less-so among others). Keys to success in the Brazilian equipment financing market are similar to those in most countries: a strong focus on risk management, careful adherence to Central Bank regulations, and effective employee recruitment and retention.

Introduction

There are several traditional reasons why United States' equipment finance companies seek to establish an international presence. Some follow their vendors or customers overseas, while others do so to support parent products. There also have been financiers, though few, which have done so as part of a market expansion strategy. This latter motivation is becoming more prevalent because of today's highly competitive US leasing and finance market and the growing global economy.

While it is true the US leads the world in the volume of equipment leasing[1], the US equipment leasing and finance industry also is very mature. This maturity includes product commoditization, slowing growth, shrinking margins, and static market share. Given this maturity, many US equipment financiers are seeking opportunities in new markets and channels to sustain asset growth and maintain profitability. The Brazilian leasing and finance market is being viewed as one of these opportunities.

Establishing financing operations outside the US

Being a successful financial company is a challenge even in one's own country – the task becomes even greater in another jurisdiction, especially when it is compounded by time and distance, such as in Brazil. There are many structural, legal, accounting, tax, and cultural differences that must be addressed.

Beyond these factors, US leasing and finance companies seeking to establish an international presence also must consider the developmental stage of the financing industry it is entering. Many emerging leasing industries, for instance, follow similar developmental patterns. They start out small and then grow very rapidly, as multiple lessors enter the market. After a relatively short period of growth and prosperity, however, there is an economic adjustment, usually in the form of a major contraction or, in some cases, a collapse.

A combination of government regulation and more rational business practices generally result in a subsequent period of slow growth, followed by a stabilization of the industry. It is at this point that the emerging leasing industry, strengthened by its trials, is poised to continue its development. The Indian, Korean, and Indonesian leasing industries, for example, followed similar patterns. By understanding this pattern, a US investor can avoid losing hard-earned traction in that industry, although the risk of this occurring in Brazil is not as likely, since the Brazilian leasing market is fairly well-established.

[1] The US originates 34.75% of the global leasing volume worldwide, according to the World Leasing Yearbook 2008.

Key differences

On a more granular level, US leasing and finance companies must make decisions such as whether to act on a cross-border basis or establish a permanent presence in the target market. Although a permanent presence generally proves to be the best formula for a sustainable strategy, due to its operational flexibility, there are many issues that need to be assessed in order to define the right structure.

It goes without saying that an equipment leasing and finance company operating internationally will face differing tax, accounting, and legal rules and regulations. These differences can be reduced to a set of common differences. For instance, although legal systems differ between countries, they generally may be classified as either common law or civil law systems. Common law systems are present in all former British colonies and protectorates such as Canada, India, and Australia. Civil law systems, on the other hand, are present in countries colonized or influenced by Continental European cultures, e.g., Spain, Portugal, France, and Germany.

Accounting regulations are always an issue in any international expansion, but there is not much divergence in the accounting for leases between countries. Many countries now follow International Financial Reporting Standard No. 17 (IFRS 17) or a local lease accounting standard based either on IFRS 17 or FASB 13. Even so, although accounting systems still may be different, in line with the local legal systems and business cultures, there is a continuing trend towards convergence of accounting standards on a global basis.

The tax systems amongst the various countries of the world also share common threads. The particulars will differ, but each country has a tax on income, some form of cost recovery, and a tax on consumption. US leasing and finance companies must still be cognizant of the differences in application of the tax laws, nonetheless. In Brazil, for example, there are three levels of income tax and lessors are taxed at different rates than the manufacturing sector.

Cultural differences also must be assessed and then addressed if the enterprise is to be successful. Special attention needs to be paid to languages, technological and physical environment, social organization, labor issues, country history, the concept of authority and political organization, religion, and even the prevailing business and social approach towards time. The many things that are taken for granted in the US business environment now become critical factors for success in an international environment.

Regulatory guidance

The numbers and nature of the regulations and rules in foreign jurisdictions represent a major difference between the US and other financing industries.

Most countries outside of the US consider equipment leasing and financing as financial activities, so they regulate such activities with the aim of ensuring transparency, professional reliability, and minimum damage to the public interest. Consequently, regulatory agencies, generally those that supervise banks and insurance companies, also have oversight of leasing and finance companies.

In many countries, finance leasing is reserved for certain financial institutions that must meet licensing requirements set forth by law, usually through the Central Bank. This is the case in Brazil, where the government restricts the right to conduct equipment leasing business to Leasing Companies, called Sociedades de Arrendamento Mercantil (SAMs), and Multiple Banks, referred to as Bancos Multiplos . In general, licenses are granted to those companies that can prove they have enough experience, skills, reliability, and capital to operate the leasing business.

Risk management

As previously mentioned, being a successful leasing and finance company is a challenge even in one’s own country and even more so internationally. An international expansion strategy, therefore, also must be supported by a very solid risk management culture and organization. The strategy also must assess unique market risks, including country, operating, currency, and funding risks. Lastly, a prudent financier will analyze and define a sound exit strategy. Managing the risks of doing business in Brazil is discussed in more detail later in the study.

Core Market Research

A full understanding of the competitive landscape and unique challenges of a new market is the key to any successful expansion strategy. The balance of this paper addresses the factors to be considered and analyses to be performed by US leasing and finance companies contemplating conducting business in Brazil.

Equipment leasing in Brazil

Equipment leasing emerged in Brazil in the mid 1960s during a period of aggressive economic policy aimed at transforming the Brazilian economy from an agricultural model to an industrialized country. The reform plan introduced by then President Juscelino Kubitschek, referred to as "50 years in 5," created the framework for a great leap in economic growth in Brazil. Within this economic context, equipment leasing emerged as a key financing alternative, since the banking system was poorly endowed to finance investment and growth.

Renta-Maq, the first leasing company in Brazil, was founded by Carlos Maria Monteiro. This small leasing company was based in Sao Paulo, which, at the time, was emerging as Brazil's most dynamic business center, since the political and economic influence of the former capital, Rio de Janeiro, was waning. The legal and tax uncertainties associated with the growing number of leasing deals led to the creation in 1970 of the Brazilian Leasing Association, better known by its acronym of ABEL.

One of ABEL's first achievements was the passage and approval of the leasing law (Lei 6.099) of 1974, which still is in force, albeit with some minor amendments. The 1974 leasing law was followed by the first leasing regulation issued by the Central Bank of Brazil in 1975. This legal framework led to the incorporation of several SAMs, all structured as financial institutions subject to the regulations of the Central Bank, and created tax incentives that, even today, favor finance leases as a vehicle for investments. This legal and regulatory framework resulted in growth of the domestic leasing portfolio from US$396 million in 1977 to US$2.6 billion in 1982.

In spite of an economic crisis in 1982, the Brazilian leasing industry kept its pace of growth and consolidation. The leasing law was amended by Lei 7.132, which opened the door to consumer leasing, cross border leasing, and syndications. In 1986, when the Government prohibited indexation of most financial transactions (in particular loans), variable rate leasing was introduced, which allowed the leasing industry to grow even more. According to Henrique de Campos Meirelles, the chairman of ABEL at the time, leasing was the one and only vehicle to finance capital investment in Brazil. It is interesting to note that Mr. Meirelles, building on his leasing experience, is the current chairman of the Central Bank of Brazil.

As Brazil started to open its economy and stimulate its exports, the government allowed SAMs to provide leases linked to the value of the US dollar. The 1994 Plano Real designed an economic policy of full convertibility and parity between the new currency, the Real, and the US dollar (R$1=US$1 at the time). This program virtually eliminated inflation in Brazil and allowed the leasing portfolio to grow 26.6% between 1994 and 1995.

Like leasing industries everywhere, Brazil has faced its share of challenges and ABEL has played an active role in promoting and protecting the growth of the leasing industry. By 1996, ABEL and the Central Bank had worked together to update the leasing company regulations to the then best practices and adopt Resolution 2.309, which is still the main regulation for the leasing industry. Operating leasing was introduced as a product option patterned after its global treatment and regulations.

In 1999, the Brazilian government was forced to abandon some of the provisions of the 1994 Plano Real and allow the Brazilian currency to float against all other foreign currencies. The net effect was a devaluation of the Real, which triggered numerous disagreements associated with the allowed indexation of rentals vis-à-vis the US dollar. Several lessees filed lawsuits seeking relief to pay rentals in US dollars, on the grounds of the unexpected economic disparity.

Fortunately for the leasing industry, the courts granted lessors the right to enforce their receivables in the local currency, provided that the lessor had outstanding foreign indebtedness. Working together, through its association, the leasing industry was able to overcome one of the tougher moments in its history. Other regulatory challenges were faced by the leasing industry between 2002 and 2004, including the treatment by the courts of guaranteed residual values (*valor residual garantido*), a concept that will be explained in detail in the Lease Accounting section of this report.

As of the end of 2007, there were 86 companies licensed to operate as lessors in Brazil. As explained earlier, leasing can be undertaken by both SAMs (of which there are 39 currently licensed and active), and Bancos Multiplos licensed to operate leasing portfolios (of which 47 currently are licensed to operate leasing portfolios).

Market size

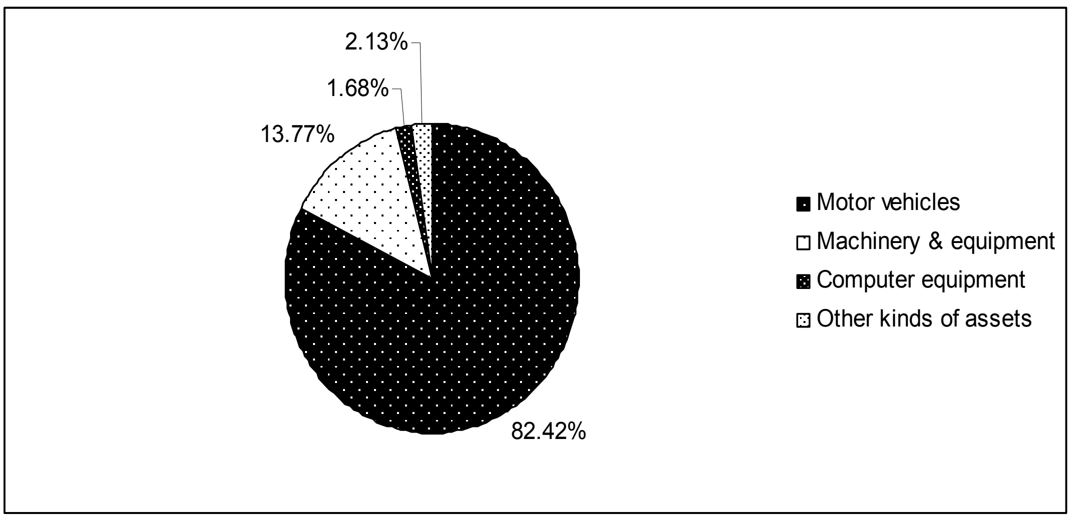
According to data gathered from official numbers of ABEL, the Central Bank of Brazil, and The Alta Group's Latin American Region (LAR) 100 report, the leasing portfolio of leasing and finance companies was US$15.9 billion as of December, 2006. Data released by ABEL, as of September, 2007, shows a domestic portfolio size of US$27.6 billion.

The Brazilian leasing market is segmented between (i) Arrendamento Mercantil, i.e., leases under the supervision of the Central Bank, which encompass all finance leases and certain forms of operating leases, and (ii) Locação, which is another form of operating leases not regulated by the Central Bank. The Arrendamentos Mercantil segment is dominated by Itau, the second largest Brazilian banking conglomerate behind Banco do Brasil. The Itau leasing group, consisting of Itauleasing, Banco Itaucard, Banco Itau, and Itaubank, has a market share of over 45% of the Brazilian leasing portfolio. This concentration has occurred even though Brazil has very rigorous antitrust laws and regulations.

Exhibit One highlights the concentration of motor vehicles in the leasing portfolio:

Exhibit One

Leased Asset Percentages



The Brazilian leasing market has been growing at an extraordinary pace in the last three years. There also have been many new entrants, most of them foreign investors, which either are equipment vendor affiliates or bank affiliates.

Lease taxation

The Brazilian tax system is extremely complex. It is governed by the Federal Constitution, resolutions of the Federal Senate, complementary laws, federal laws, and state and municipal laws. The Brazilian Tax Code (Law No. 5.172 of

1966) sets forth the general tax rules in Brazil. The tax burden on the Brazilian economy represents 40% of the GPD, which has increased from 24% in 1994, according to the Instituto Brasileiro de Planejamento Tributário.

The Federal Constitution establishes the limitations on the power to tax and grants tax authority across the various levels of government, as well as tax revenue sharing provisions. It has given the Union (Federal Government), the 26 states (including the Federal District–Brasília), and the municipalities the authority to collect taxes, fees (public services), and improvement charges (public works). Social contributions, such as Social Security, primarily only may be established by the Federal Government.

Brazilian society has been calling for tax reform because the complexity of the tax system and volume of tax payments is seen as an obstacle to the further economic development of Brazil. The problem is that the governments (federal, state, and municipal) are not interested in any tax reform, as they are afraid that any change in the system may reduce their tax revenues, thereby forcing budget cuts. As discussed earlier, the tax burden actually has been increasing instead of decreasing.

There are several taxes that directly or indirectly affect leasing and financing transactions

- Corporate income taxes
- Withholding tax
- Social contribution
- Tax on financial transactions (IOF)
- State and local taxes

Corporate income taxes

The corporate income tax in Brazil is a combination of three taxes - the basic income tax of 15%, a 10% surtax (due whenever tax basis exceeds a defined amount), and the Social Security Contribution on Net Earnings (*Contribuiçao Social sobre Lucros Liquidos*, or CSLL). The CSLL, effective April 1, 2008, is 15% for financial institutions, including equipment lessors[2], and is 9% for all others. The effective corporate tax rate in Brazil, effective 2008, therefore, is 40% for financial institutions, including leasing companies, but only 34% for all other corporations. **Table I** illustrates the various tax rates.

[2] The CSLL was established under Brazilian Law through Lei 7.689 of 1988, and has been further reformed by different statutes. In January 3, 2008, for example, the Brazilian Government adopted Medida Provisoria 413, adjusting the rates to their current level, as mentioned above.

Table I
Income Tax Rates

Tax	Rate	
	Financial institutions	Other companies
Basic income tax rate	15%	15%
Surtax	10%	10%
CSLL	15%	9%
Total tax rate	40%	34%

Income tax returns are due by March of the following year. Although, in general, income tax is payable based on either the real, presumed, or imputed profits, Article No. 246 of RIR/99(b) states that "financial institutions or their equivalent" are required to compute their tax assessment based on real profits. This means that there is no alternative minimum tax for financial institutions, including Banco Multiplos and SAMs.

Under the real profit regime, a company may opt for its final tax liability to be determined either on an annual basis or on a quarterly basis. The majority of companies adopt the so-called "annual real profit" alternative, so they can offset profits arising in one quarter with losses arising in a subsequent quarter within the same accounting year.

As in the US, companies must pay taxes on an estimated basis. These estimated taxes must be paid monthly and are calculated based on estimated profits (determined as a fixed percentage of revenue) times the 15% base tax rate. The fixed percentage of revenue for estimated tax purposes depends upon the nature of the company's activities. Financial institutions are required to apply a fixed percentage of 16% to their revenue. Hence on a monthly basis, a lessor would calculate 16% of its total revenues and apply the 15% corporate income tax rate to determine the monthly amount of estimated taxes to be paid.

Withholding Tax

Withholding tax is levied on payment, credit, or remittance of interest or capital gains, to a person/legal entity domiciled abroad. The general rate is 15%, and tax is withheld on royalties at 15%, and on interest at 15%. No taxes are withheld on dividends. On a grossed-up basis, the effective tax rate of withholding taxes on interest becomes 17.65%.

Social Security Contribution (CSLL)

In addition to the liability for income tax on profits, a company is liable for the social contribution tax upon its income and capital gains. This social contribution tax is not deductible in calculating either corporate income tax or the contribution tax itself and generally the tax base for the contribution tax is the same as that for corporate income tax.

The rate for financial institutions, effective April 1, 2008, is 15%. When the income tax is paid monthly on an estimated basis, the social contribution should be calculated on an estimated tax basis of 12% of the company's gross revenue. When the income tax is paid quarterly on an actual basis, the social contribution should be calculated at 12 per cent of the actual profits.

IOF (Tax on financial transactions)

It is important to mention that leases are not subject to the IOF. This is an important advantage of this financial service in Brazil. However, IOF applies to all other financial services and may be levied, as necessary, on credit, currency exchange, insurance, and securities negotiation. IOF rates may be raised and lowered at any time, in order to address funding gaps. The rate currently in force is 0.0041% per day for companies and corporations, and 0.0822% for consumers.

State and local taxes

The Imposto Sobre Circulação de Mercadorias e Prestação de Serviços (ICMS), which is equivalent to VAT, is a state-level tax. It is an important item in the cost of any equipment purchased or sold in all the Brazilian states and also affects all imported equipment. The rate may vary from 12% to 18% of the cost of the goods, depending on the state where the goods are produced or imported. In certain states, some types of equipment (those of "national interest" or "of relevant utilization" such as airplanes and medical equipment) may be exempt from this tax when imported into the country.

There are no special state taxes on financial services, but there is a municipal tax on services called the ISS. The ISS ranges from 0.5 to 10%, depending on the type of service rendered. The ISS also varies from municipality to municipality, and affects certain financial services. The ISS is levied by the municipality in which the lessor is headquartered, and should be billed and collected from customers like a value added tax. Leasing enjoys the dubious distinction of being the only financial service subject to the ISS in Brazil.

Selecting the right location is critical for optimal tax management. In large urban centers, such as the downtown areas of Sao Paulo or Rio de Janeiro, the ISS is very high. In certain suburbs of these cities, however, the ISS is lower. There is a growing tendency in several municipalities to assess ISS on nonresidents on the grounds that their own residents have contracted services with such non-residents. These cities tend to apply the concept of permanent establishment and nexus to any business operating in their jurisdiction. This is a growing concern and an open issue that most lessors have faced.

Under the current tax environment, leasing presents advantages over loans for a company that needs deductible expenses in order to reduce its tax liability. This beneficial tax treatment that was established in 1974 has survived several tax reforms, and still is the rule. Whether the lease is an operating lease or a finance lease, the lessee is entitled to claim rentals paid under such lease as a cost or expense.[3]

Lease accounting

In terms of accounting requirements, Brazil has traditionally followed the rules and standards of the International Accounting Standards Board. Currently, Brazil is very active in implementing International Financial Reporting Standards[4], to the point that such standards will become mandatory as of January 1st, 2010 for all public companies listed in Brazilian stock exchanges.

The Central Bank of Brazil regulates accounting rules applicable to all financial institutions. The Central Bank has adopted specific accounting rules for lessors that are applicable to both Banco Multiplos with leasing portfolios and to SAMs. Such rules combine the international accounting standards, in particular IFRS 17, Leases, and the principles embodied in the Brazilian legal and tax system.

When it comes to accounting for leases, Brazilian accounting standards, like the rest of the world, recognize two types of leases. The classification of these lease types, referred to as finance and operating leases, is based on the statutory definition of such leases. Form prevails over substance in Brazil, so the lessor is always the legal owner of the leased asset regardless of whether the lease is a finance or operating lease.

A finance lease is a lease in which the lessor, through the rentals only, recovers the cost of the equipment[5]. The Courts have ruled that in all finance leases, the lessee assumes the residual risk of the equipment, whether or not the ownership of the leased asset transferred to the lessee at the conclusion of the lease term[6].

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3 Lei 6.099, 1974.

4 In 2005, the Brazilian Federal Accounting Committee embraced the convergence of international accounting principles, and thus created the Brazilian Accounting Standard Board or Comitê de Pronunciamentos Contábeis (CPC).

5 Resolution 2.309, 1996 Central Bank of Brazil.

6 This was an interesting construction of the legal nature of financial leases, based not on whether or not the lease payments amortized the equipment cost or whether or not there was a bargain purchase option, but instead about who assumed the residual risk. If the lessee, the lease is financial, otherwise should be operating.

This is a unique feature of Brazilian leasing regulation. Under a finance lease, the lessee guarantees the residual value, hence the primary concept that distinguishes a finance lease is the existence or not of a residual value guarantee, or Valor Residual Garantido.

In an operating lease, just as in the US, the lessor assumes the risk of residual value of the asset, and there is no automatic transfer of the asset at lease-end. The Brazilian accounting tests for operating leases are very similar to those of FAS 13 and IFRS 17.[7] A lease is classified as an operating lease if any of the following criteria are met:

- The present value of the lease payments is less than 90% of the asset purchase price.
- The lease term exceeds 75% of the useful life of the asset class
- The purchase option is for fair market value
- There is no obligation to lessee to pay a guaranteed residual value[8]

Lessor accounting for finance leases in Brazil is unique. According to the Accounting Plan for Financial Institutions (COSIF), lessors must record all lease receivables as account receivables and then net out any unaccrued rentals as of the date of the financial statements. The lessor then records the cost of the equipment, net of depreciation. This net book value is adjusted to reflect a balance equal to the net present value of the rentals.

The final balance shows the net present value of the rentals, plus all past due rentals related to the lessor's asset. This treatment achieves the same bottom line as a lessor applying US GAAP accounting, but has the added benefit of eliminating the Civil Law dispute about whether or not, in finance leases, the title of equipment is held by the lessor.

Leasing associations

The Brazilian Leasing Association (ABEL) has been instrumental in the development of the equipment leasing industry in Brazil. A listing of the top Brazilian finance lessors can be found on page 42.

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[7] Law 11.638 amended Brazilian GAAP in December 2007 to require capitalization of the lease rentals by the lessee. Although the tax law clearly allows the deduction of lease rentals, the capitalization of the rents for accounting purposes has created some concern that the tax deductibility of the rents in an operating lease may not be allowed.

[8] Resolution 2465, 1999 Central Bank of Brazil that amended article 6 of the Resolution 2309, 1996.

Current Developments

The Brazilian economy recently has shown indications of continuous and sustainable improvements. The economic policies of the current government have reduced inflation, lowered interest rates to levels consistent with prevailing capital markets, and expanded the export capabilities of the country. In addition to being a global leader in exports of certain agricultural commodities, Brazil also has a strong local manufacturing sector.

Brazilian companies such as Petrobras, Votorantim, Companhia Vale do Rio Doce, Construtora Norberto Oderbrecht, and others are leading global investors in their corresponding fields. A recent oil discovery in Brazil may put Brazil among the top global oil producers, which, when added to its global leadership in biofuels such as ethanol, offer substantial potential for economic growth and opportunities.

The equipment leasing industry in 2007 experienced a growth rate of over 80%, although most investments were in the motor vehicle marketplace. There is enormous room for growth and diversification of the leasing industry among other capital goods, considering that Brazil is the headquarters of major global equipment manufacturers such as Embraer (aircraft), Marco Polo (transportation equipment), and Positivo Informática and Itautech (information technology equipment). Furthermore, the legal, tax and accounting environment are, in general, friendly to leasing business, the high tax burden notwithstanding.

Establishing a Leasing Company in Brazil

As mentioned, only Bancos Multiplos and SAMs may offer equipment leasing as a financial service. Other forms of operating leases can be undertaken under the locação structure. Since locação is not a regulated activity, however, this analysis will be restricted to the steps to create a regulated leasing company. Furthermore, there is a clear distinction between domestic and foreign-invested leasing companies in Brazil from a rules and regulations perspective.

Presidential Decree

Article 192 of the Brazilian Federal Constitution provides that the national financial system must be regulated by legislation passed by Congress. Among other aspects, the conditions for foreign investments in domestic financial institutions must be defined. Article 52 further provides that, until such conditions are set forth, new agencies of financial institutions domiciled abroad are not permitted in Brazil. Individuals and legal entities domiciled abroad also are not permitted to increase their investments in the capital of financial institutions operating in Brazil.

However, Article 52 determines that these restrictions are not applicable when the investment is deemed to be of national interest, in which case a presidential decree is required. Additionally, Article 18 of Law 4.595/64 determines how authorizations may be obtained for foreign institutions to operate in the Brazilian markets.

Branch License granted by the Central Bank

The main conditions that must be met prior to the Central Bank's approval for a foreign financial institution to set up a branch in Brazil are regulated by Resolution 3040 (2002), issued by the National Monetary Council, and Circular 3317 (2006), issued by the Central Bank of Brazil.

According to Circular 3317, the information in **Table II** must be provided to the Central Bank in regards to applications filed by foreign persons to operate in the Brazilian financial sector. Resolution 3040, of 2002, sets down the conditions to be met both by Brazilian and foreign applicants to operate in the domestic financial system. The main aspects of these regulations are listed in Appendix One.

Studies developed by the Central Bank conclude that better supervisory practices tend to be facilitated if foreign groups operate in the Brazilian financial system by means of subsidiaries, rather than through branches. The reason for this is that subsidiaries are formally incorporated in Brazil and are subject to the domestic legal and regulatory framework, which reduces the number of the cross-border regulatory problems more likely to appear with foreign companies operating as branches.

Table II

Application Information (Foreign Investors)

- The amount of foreign participation in the total capital of a local subsidiary of a financial institution.
- The 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.
- A detailed description of existing activities of the foreign investor in the Brazilian financial system, including any participation in local economic groups.
- The relevance of the local operations to the strategic plans of the foreign investor, including added-value analysis on any existing operations in Brazil.
- The risk rating classification of the applicant, including the entire economic group, if applicable.
- An indication of any financial institutions that maintain direct or indirect relations with the financial institution domiciled abroad.
- An indication of regulatory bodies that supervise the financial institution domiciled abroad (such as the Federal Reserve Systems, the Office of the Comptroller of the Currency or any other similar authority), if applicable.
- Other information considered relevant for the analysis by the Brazilian government on the issue.

There are no substantial differences between the legal and regulatory frameworks applicable to financial institutions controlled by Brazilian residents and those controlled by foreigners operating in Brazil (branches and subsidiaries). At the end of the day, both Brazilian and foreign financial firms must operate in compliance with the same basic set of rules.

Minimum Capital

According to Resolution 2607 (1999), issued by the National Monetary Council, financial and other institutions chartered by the Central Bank of Brazil, and legally authorized to undertake the business of equipment leasing, must permanently meet the following minimum limits regarding paid-in capital and net equity.

- Leasing portfolios require R$7,000,000 of capital[9]
- Commercial bank portfolios require R$17,500,000 of capital

In the case of Banco Multiplos, minimum capital requirements are dependent upon the types of portfolios held. The minimum capital requirement for such institutions is based on the sum of the capital requirement for each portfolio. For instance, a Banco Multiplo with a commercial bank portfolio and a leasing portfolio would have a minimum capital requirement of R$24,500,000 [R$17,500,000 (commercial bank portfolio) + R$7,000,000 (leasing portfolio)].

Financial institutions may activate up to 10 branches without triggering additional capital requirements. Beyond this limit, 2% will be added to the required paid-in capital and net equity per branch in the states of Rio de Janeiro and São Paulo and 1% per branch in the other states. An institution with at least 90% of its branches located outside the states of Rio de Janeiro and São Paulo, including its head office, will have its paid-in capital and net equity requirements decreased by 30%. The paid-in capital and net equity minimum limits for banks is increased by R$6.5 million if foreign exchange market operations are carried out.[10]

The Central Bank of Brazil also has defined minimum capital requirements in line with the guidelines set forth by the Basel Committee on Banking Supervision. For example, Banco Multiplos and SAMs are required to hold capital of at least 11% of their risk-weighted assets instead of 8% as stated in the Basel Capital Accord. Further capital also can be required to cover the markets risks of derivatives, prefixed interest rate operations, and the market risk related to operations that are sensitive to exchange rate variations.

Approvals and time required

In general, the time necessary to obtain a license from the Central Bank of Brazil can take between 6 to 9 months, according to the experience of the market participants interviewed for this paper.

[9] At the time of this paper, the prevailing exchange rate is R$1.70=US$ 1. This means that such minimum capital for carrying out leasing portfolios, would be equivalent today to US$4,117,647.

[10] Further information, is available at the International Capital and Foreign Exchange Market Regulation – RMCCI available on the Central Bank of Brazil website - http://www.bcb.gov.br/rex/LegCE/Ingl/Ftp/RMCCI-I.pdf

Partnership considerations

Although it is not mandatory to have Brazilian partners, the expertise these partners can bring to the operation can be invaluable. In addition, as previously mentioned, foreign investment in new or existing leasing companies normally requires a Presidential Decree to be approved.

Aside from a much lower paid-in capital requirement, local partners offer the following advantages that are particularly important in Brazil:

- **Local market knowledge –** Experienced Brazilian leasing and finance companies will be familiar with local businesses, credit histories, and the reputations of many local business leaders and their companies.

- **Existing business relationships –** Brazilian partners may bring an existing portfolio, business relationships, or both, to a partnership. Depending on the desire of the international leasing and finance company, this may allow the partnership to begin operations with a critical mass and core set of clients.

- **Staffing –** Beginning leasing and financing operations with an experienced staff can make an important difference in Brazil. Although there is no shortage of talent in the finance industry in Brazil, finding senior employees with the appropriate experience, and at a competitive cost, is a challenge.

- **Familiarity with the Brazilian legal system –** Brazil has a Civil Law system that allows the possibility of contradictory court decisions. This is particularly relevant in certain areas of the country such as the Parana-Rio Grande Do Sul region, or the Northeast, where the courts rule more based upon socio-economic considerations rather than legal. In certain regions, the Consumer Protection Code has been applied in spite of the fact that the statute acknowledges that leasing is not a consumer transaction. Having a local partner helps to anticipate the outcome of litigation in certain environments and to assist in achieving better outcomes.

- **Speed to market –** An experienced Brazilian partner can save time through its knowledge of what leasing products are most popular, what marketing and advertising media are effective, which companies may be the best potential customers, and how to get approvals and credit information faster and more effectively.

- **Language –** This is a particularly important issue in Brazil. Although bilingual education is available, there are not too many bilingual business executives. Knowledge of the Portuguese language, naturally, is highly desirable.

Funding and currency considerations

Funding options available to leasing and finance companies in Brazil are the most developed of all emerging markets in which leasing operates. In general terms, the funding sources for leasing and finance companies in Brazil are domestic bank loans, cross border loans (subject to registration at the Financial Operations Registry of the Central Bank and certain minimal regulation), and commercial paper or debentures that are placed in the capital markets.

Banco Multiplos with leasing portfolios also have the option to fund their deals in so-called CDIs (Certificado de Depósito Interbancário or interbank certificates of deposit)[11], which are treasury investments for banks and financial institutions. CDIs are subject to fewer restrictions based upon their credit rating and, thus, can be less expensive than any other funding source.

One of the most widely used funding instruments in Brazil is the use of debentures. Debentures are bonds issued with mid-term to long-term maturities and normally are underwritten by the banks. Leasing and finance companies that are affiliates of banks use this mechanism often. Lately, such debentures have been issued as subordinated and perpetual (without an amortization schedule, but with a call option to repurchase by the issuer).

Some banks held the funds raised from their affiliate lessors in the bank's treasury, thereby circumventing the Central Bank regulations concerning cash reserves. By the end of January, 2008, as reported by Latin Finance:

> "Brazil's Central Bank has issued rules introducing reserve requirements for leasing company debentures held by banks. In May, the rate will need to be 5%, and will move up to 25% in January 2009. Banks have to meet this reserve requirement with the deposit of government bonds at the central bank. Many leasing companies fund themselves by selling debentures to their parent institutions. UBS says the decision by the central bank may limit that option going forward. We believe new requirement reduces incentive for leasing companies to issue more debentures and could add pressure to banks' liquidity and funding costs, ¨ says the shop. The move is seen as a means to rein in credit growth and control aggregate demand, according to a report from Bradesco BBI, and the larger banks will be most affected. Bradesco has BRL32bn in open market operations with leasing debentures as collateral, Itau BRL40bn and

[11] Created by means of Resolution 1.102 of 1986 of the National Monetary Council, it empowers banks to issue certificates of deposits to be negotiated with all other banks at a prevailing interbank interest rate. The CDI rate has become the banking system referential rate, not to be confused with the SELIC rate which is the Central Bank discount rate.

> Unibanco BRL14.6bn, according to BBI. Banco do Brasil does not use debentures as a funding instrument"[12]

On a cautionary note, Rezeita Federal, the Brazilian tax authority, disallowed the interest deduction on intercompany debt in a recent case. Debentures, however, have proven to be a formidable funding instrument for leasing companies and the local capital markets in Brazil are eager to funnel funds there. This funding alternative is, without a doubt, one that new lessors to Brazil should investigate.

Staffing

Brazil has a hard-working population and its culture reflects the general understanding that continuous education and hard work represent keys to success. This fact is reflected in an 88.6% adult literacy rate in Brazil relative to 79.1% for the world as a whole.

Despite a literate and generally well-educated work force, and the long-standing nature of the leasing industry, staffing still represents one of the biggest challenges for leasing and finance companies in Brazil, particularly as it relates to work performance. While there are some experienced leasing personnel at all levels, from executive management to administrative staff, most of them have been raised in an environment in which leasing tends to be treated as a commodity. As a result, innovation is not encouraged, a factor exacerbated by the inherent bureaucracy associated with prevailing business patterns. Most foreign lessors bring in expatriate management at the commencement of operations, and hire and train local management during the first two to three years of operations.

The employment system in Brazil is very complex, highly protected and rigid[13], so leasing and finance companies must be cognizant of the domestic picture, including statutes, case law, and prevailing practices. Most of the employment contracts are subject to minimum statutory benefits and to the conditions set forth under collective bargaining agreements with the employment unions. The banking and leasing industries have their corresponding collective bargaining agreements that bind all the members of the industry[14]. This is one aspect that must be taken into consideration when planning and managing human resources, compensation, and employment relationships in Brazil.

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[12] Latin Finance Daily Brief, February 4, 2008. Available on a daily basis at: www.latinfinance.com/daily

[13] Data from the World Bank "Doing Business 2008" program ranks Brazil 119 among 178 in terms of one of the most difficult country environments to hire employees, and expensive in terms of holding and firing employees. The reality is that all employees in Brazil are subject by Statute to a "carnet" system and are protected by Statute and by the Unions. The carnet system invokes a socialist, centrally-planned work force. Under this system, when an individual enters the work force, he or she receives an identification called a carnet that is carried all the person's life and that is used to track the employee's work history.

[14] The latest collective bargain employment agreement binding to the leasing industry can be downloaded from the Brazilian companies' union website: http://www.sindicatodeleasing.org.br/Paginas/convencoes_coletivas.asp.

Systems and service providers

The lease service provider market in Brazil is comparable to that in western countries. There are several IT leasing systems in the marketplace that are well-developed and tailored to the Brazilian environment. Currently, there are several IT systems providers with support offices in Brazil, more than 11,000 indigenous software companies, and very advanced systems in terms of banking payments (80% of 20 billion bank transactions are made automatically via ATM, telephone, and the Web).

Serasa, a Brazilian company originally founded by 78 banks, and that developed a sophisticated credit scoring system, was recently acquired by Experian. E-commerce also is highly developed in Brazil, although the lag in the efficiency of the legal system has deterred any major development in fields such as e-documents.

In addition, there are many lease servicing/collections firms and some onshore asset management specialists, although the large concentration in motor vehicles presents a challenge for other equipment items such as IT and industrial equipment. Tax, accounting, legal, and consulting services are available from the larger global consultants, but there also are local professionals that specialize in leasing. Most consultants are located in Sao Paulo and Rio de Janeiro, but large firms tend to have offices in other principal cities such as Porto Alegre, Belo Horizonte and Manaus.

Geographical considerations

Brazil is the largest South American country and has the fifth largest population in the world. Most of its economic activity is concentrated in the southeast region of the country. Based on size and socio-economic distribution, it is easy to visualize the economic opportunity and potential operational challenges of the country, as illustrated in **Exhibit Two**.

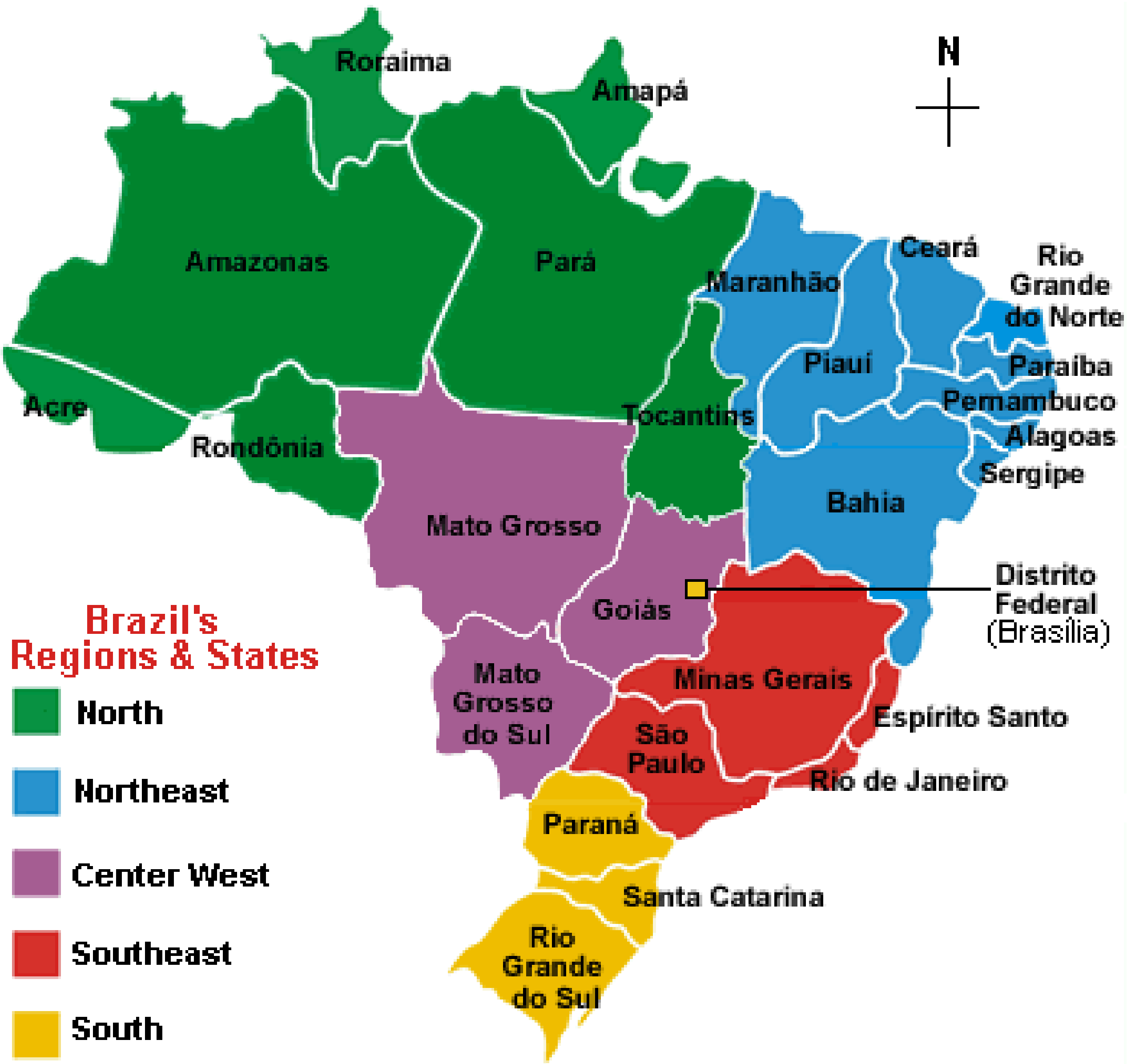
Brazil is a Federation of twenty-six states and one federal district (Distrito Federal) that is divided, for demographic and statistical purposes, into five main regions: North, Northeast, Central-West, Southeast, and South.

The North region, comprising the states of Rondonia, Acre, Amazonas, Roraima, Pará, Amapá and Tocantins, covers 45.27% of the surface of Brazil, and has the lowest number of inhabitants. With the exception of Manaus (in the State of Amazonas), which hosts a tax-free industrial zone, and Belém (in the State of Pará), the biggest metropolitan area of the region, the North is fairly unindustrialized and undeveloped. It encompasses most of the rainforest vegetation of the world and many indigenous tribes.

The Northeast region, consisting of the states of Maranhao, Piaui, Ceará, Rio

Exhibit Two

Map of Brazil and Its States



Grande do Norte, Paraiba, Pernambuco, Alagoas, Sergipe, and Bahia, is inhabited by about 30% of Brazil's population. It is culturally diverse, with roots set in the Portuguese colonial period, and in Amerindian and Afro-Brazilian elements. It also is the poorest region of Brazil, and suffers from long periods of dry climate. The largest cities are Salvador (in the State of Bahía), Recife (in the State of Pernambuco) and Fortaleza (in the State of Ceará).

The Central-West region, comprising the states of Mato Grosso, Mato Grosso do Sul, Goias and the Federal District (where the capital Brasilia is located) has low demographic density when compared to the other regions, mostly because a part of its territory is covered by the world's largest marshlands area, the Pantanal, as well as a small part of the Amazon Rainforest in the northwest. However, much of the region also is covered by Cerrado, the largest savanna in the world, which a recent issue of Fortune magazine identified as the world’s largest soybean harvesting area. The Central-West region contributes significantly towards agriculture. The largest cities of this region are: Brasília (the capital), Goiânia, Campo Grande, and Cuiabá.

The Southeast region, which consists of the States of Sao Paulo, Minas Gerais, Espirito Santo and Rio de Janeiro, is the richest and most densely populated. It has more inhabitants than any other South American country, and hosts one of the largest megalopolises of the world. The main cities also are the country's two largest; São Paulo and Rio de Janeiro. The region is very diverse, including the major business center of São Paulo, the historical cities of Minas Gerais and its capital Belo Horizonte, the third-largest metropolitan area in Brazil, the beaches of Rio de Janeiro, and the coast of Espírito Santo.

The South region, comprising the States of Paraná, Santa Catarina, and Rio Grande do Sul, is the wealthiest by GDP per capita, and has the highest standard of living in the country. It also is the coldest region of Brazil, with occasional occurrences of frost and snow at some of the higher altitudes. It has been settled mainly by European immigrants, mostly of Italian, German and Portuguese ancestry, and clearly is influenced by these cultures. The largest cities in this region are Curitiba, Porto Alegre, Florianópolis, Londrina, Caxias do Sul, and Joinville.

Risk Considerations

Any equipment leasing and finance company seeking to establish a presence outside the US must carefully consider the unique risks inherent in that jurisdiction. Although the analysis may not be much different than one performs in entering a new market in the US, it is important to remember that the differences in culture, economy, time, and distance magnify the risks, concerns, and operating issues.

Market entry risk

Sovereign risk is a prime example of the type of unique risks that US lessors may face internationally but do not have to contend with at home.

Sovereign risk is a prime example of the type of unique risks that US lessors may face internationally but do not have to contend with at home. This risk can be considered from two different perspectives. One is political risk, which is the likelihood that a given country would subject foreign and/or domestic investors to measures that would impair the security of enjoyment of life, freedom, and property. In concrete terms, such political events are political violence and revolution, expropriation, and other factors such as government breach of contracts. The second sovereign risk relates to the ability and willingness of governments to pay their debts.

In terms of protection of property, the US Department of Commerce has stated that:

> "There have been no expropriatory actions in Brazil in the recent past nor any signs that the current Government is contemplating such actions. In 1999, a state government sought and obtained a court ruling canceling contractual obligations, signed by the prior state government, associated with the partial privatization of a state electricity company. The U.S. investors are appealing the court ruling. In 2003, a newly inaugurated government in another state refused to honor a number of contracts the previous state government had signed with a range of Brazilian and foreign investors; the parties involved continue to negotiate these contract disputes and have had recourse to local courts. Some claims regarding land expropriations by state agencies many years ago have been judged by courts in US citizens' favor. There remain individuals who have not yet been compensated because the states have appealed these decisions."[15]

[15] United States Department of Commerce. Brazil Country Commercial Guide 2007, Page 51 of 73 in: www.export.gov

The bottom line, however, is that no record of abusive expropriation exists and that the Brazilian Constitution grants protection to property of foreign persons in Brazil. In addition, multinational corporations and foreign investors have become more familiar with the remedies beyond the national legal systems such as those under international law. The most preferred forum to exercise such remedies is the International Center for the Settlement of Investment Disputes, along with the various bilateral investment treaties and free trade agreements.

In this respect:

> "…Brazil is not a member of the International Center for the Settlement of Investment Disputes (ICSID-also known as the Washington Convention), but it is a party to the New York Convention of 1958 on the recognition and enforcement of foreign arbitration awards. In August 1995, Brazil ratified the 1975 Interamerican Convention on International Commercial Arbitration, as well as the 1979 Interamerican Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards. …There is some legal controversy in Brazil over binding foreign arbitration between foreign investors and state entities. Some Brazilian legal interpretations claim this is prohibited under Brazilian law on the grounds that it infringes the sovereign rights of the state. The Federal Government nevertheless maintains, in the absence of a definitive judicial ruling on the issue, that it can agree to binding foreign arbitration and routinely enters into contracts that allow for such arbitration.
>
> This legal uncertainty, as well as congressional politics, has held up ratification of Bilateral Investment Agreements that Brazil has signed with fourteen countries (not including the U.S.), which call for arbitration by either ICSID or a panel set up under the United Nations Rules for International Commercial Law. Given the doubts about the applicability under Brazilian law of these international arbitration provisions to Brazilian government entities, the government in December 2003 withdrew the agreements from consideration for Senate ratification"[16].

Brazil has an effective record regarding subversion and combating terrorism. According to Privacy International, "The Government of Brazil extended practical, effective support to US counterterrorism efforts (since) 2002."[17] Recent police and army actions have proven that Brazil does not tolerate the sheltering of terrorists or narcotics traffickers. The foregoing notwithstanding, Brazil nevertheless has a high level of crime, especially in urban cities, that requires caution when traveling. There is nothing, however, that may dramatically impair the value of foreign investments.

[16] Ibidem.
[17] Brazil Terrorism profile, in www.privacy.org

From a sovereign risk perspective, Brazil is considered to be just one notch below investment grade with a general consensus that it will become an investment grade country in a relatively short period of time.

Regulatory

Brazil is open to, and encourages, foreign investment. The Brazilian Congress, for example, approved constitutional amendments in 1995 to eliminate the distinction between foreign and national capital. Foreign investors have been permitted to invest in the Brazilian stock market since 1991. Additionally, new rules in 2000, which considerably liberalized foreign investment in equities, put foreign investors essentially on an equal footing with Brazilians.

The 1962 Foreign Capital law and subsequent amendments govern most foreign investment. During the high point of its privatization program, Brazil was the second largest destination for foreign investment among emerging markets, with a peak inflow of $32.8 billion in 2000. The country remains a leading investment destination, as, according to the most recent study performed by the Economist Intelligence Unit, Brazil ranked 14th in 2006 among destinations for global foreign investment[18].

The issue of permanent establishment is one of primary concern for captives. Unless captives operate on a cross border leasing basis, through the Central Bank's registration process, any other continuous activities may be construed as permanent establishment, thereby requiring either the creation of a branch or the incorporation of a new company. If an activity, other than cross border leasing, is to be undertaken by a captive on a permanent basis, it shall be suggested that a separate company be incorporated, preferably a locadora, unless the specific offerings fall into the scope of the financial institutions regulated by the Central Bank.

Foreigners investing in Brazil must register their investment with the Central Bank within 30 days of the inflow of resources to Brazil. Registration is done electronically. Investments involving royalties and technology transfer must be registered with the patent office (INPI) as well. Investors must have a representative in Brazil and register with the Brazilian securities commission (CVM). Subsequent transactions, such as reinvestment of profits, also may have to be registered with the Central Bank.

Foreign investors, upon registering their investment with the Central Bank, are able to remit dividends, capital (including capital gains), and, if applicable, royalties, although these remittances must be registered with the Central Bank. The remittance transaction may be carried out at any bank by documenting the

[18] The Economist Intelligence Unit and the Columbia Program on International Investment "World investment prospects to 2011: Foreign direct investment and the challenge of political risk", 2007

source of the transaction (evidence of profit or sale of assets) and showing that applicable taxes have been paid.

In addition, leasing and finance companies are subject to the regulation of the Central Bank of Brazil, including their risk management policies and procedures, their capital allocation, and the fair presentation of financial statements. As mentioned, pursuant to Brazilian Law, only certain financial institutions licensed by the Central Bank legally are entitled to operate as lessors in Brazil. These financial institutions are SAMs and Banco Multiplos that are licensed to operate and hold a leasing portfolio.

Although the regulation is quite comprehensive and requires resources within a lessor's staff, it has proven to be very conducive to the development of the leasing industry. Most of the reports are handled electronically through the SISBACEN system (Central Bank Information System). Furthermore, the high level of professionalism of the Brazilian Central Bank ensures that almost all regulations are in line with the best practices of the leasing industry worldwide as far as risk management, transparency, and solvency protection are concerned.

Structure

There are two structural alternatives available to leasing companies, which are SAMs and Banco Multiplos licensed to run leasing portfolios. These alternatives require incorporation of subsidiaries or participation in the capital of existing companies, therefore, operating through branches is ruled out. Nevertheless, a foreign lessor offering cross border leasing may open a representative office in Brazil with the sole purpose of promoting such cross border leases.

In addition, for certain operating leases that, legally speaking, may not fit into the definition of arrendamento mercantil, pursuant to Central Bank regulations, certain foreign investors have opted to create a company that operates traditional rental agreements, so called locaçãos. Such companies are not subject to the control of the Central Bank but must not structure transactions in such a way that, in substance, such transactions might be construed as arrendamento mercantil. Should the rental company be construed as offering arrendamento mercantils, then the Central Bank has the power to take over the company and wind it up on the grounds that such a company is performing activities legally reserved for financial institutions.

When choosing a structure, having a Banco Multiplos license to run a leasing portfolio presents the following advantages:

- SAMs do not have access to the foreign exchange and interest rates hedge markets, while Banco Multiplos do.[19] This brings the advantage of

[19] There is a very well established hedge market in Brazil, which functions through the Mercantile and Futures Exchange (BM&F). The Brazilian Mercantile & Futures Exchange S.A. is one of the world's

being able to reduce volatility associated with the cost of funds, and better manage liquidity risk

- SAMs may not legally offer loan financing, a product that usually is regarded as important in vendor financing for tenors shorter than two years. Banco Multiplos, on the other hand can offer loan financing

SAMs have very limited[20] access to funding from the Brazilian National Development Bank, through its FINAME ("Financiamento a Máquinas e Equipamentos") Program. This program provides government subsidized funding for financial institutions in order to offer equipment financing to certain sectors deemed critical for Brazilian economic development. Banco Multiplos, as discussed earlier, have wider access to FINAME[21]. A detailed listing of FINAME's programs and scope is attached in the Appendix.

Operational risk

Operational risks also must be considered when entering the Brazilian market as they have a direct impact on the day-to-day business of the lessor and, hence, its profitability.

Market

Market risks are a fact of life for any business whether it is in the US or Brazil. Interestingly enough, one of the market challenges leasing and finance companies were facing in the US prior to the 2007 sub-prime meltdown also is present in Brazil – the Brazilian market is flush with liquidity.

The other factor that mitigates market risks for lessors is the availability of equipment in the economy. Brazil has the advantage that besides having solid foreign reserves that permit it to finance imports of capital goods, it also has a

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largest futures exchanges, the largest in Latin America based on number of contracts traded and the only futures exchange operating in Brazil. BM&F develops and manages systems for the trading and settlement of securities and derivatives products based on interest rates, foreign exchange, equity and inflation indices, financial indicators, commodities (including environmental commodities), energy prices, transportation and climate, for both immediate and future settlement. The BM&F seeks to provide its clients with products that allow them to hedge against risks, arbitrage prices between markets and/or securities, diversify investment allocations and leverage investment strategies. Further information is available in http://www.bmf.com.br/portal/pages/institucional2/conheca_bmf/Perfil_Corporativo.asp (

[20] Access by SAMs to FINAME is very limited. SAMs, both domestic or foreign owned, are allowed to access funding from Banco National de Desenvolvimento Economico e Social ("BNDES"), ---FINAME, for the sole purpose of financing the items that are described on a list of certified manufacturers and its products. The other requirement is that the interest rate should be the one published by BNDES in its website, based upon either a basket of rates of several different currencies or the TJL (Long-term Interest Rate), which has already been described earlier.

[21] Certain players, such as De Lage Landen, have their whole portfolio funded by FINAME in Brazil, using its Banco Multiplos structure.

very robust domestic industry that manufactures capital goods. As a result, lessors operating in Brazil are not short of product.

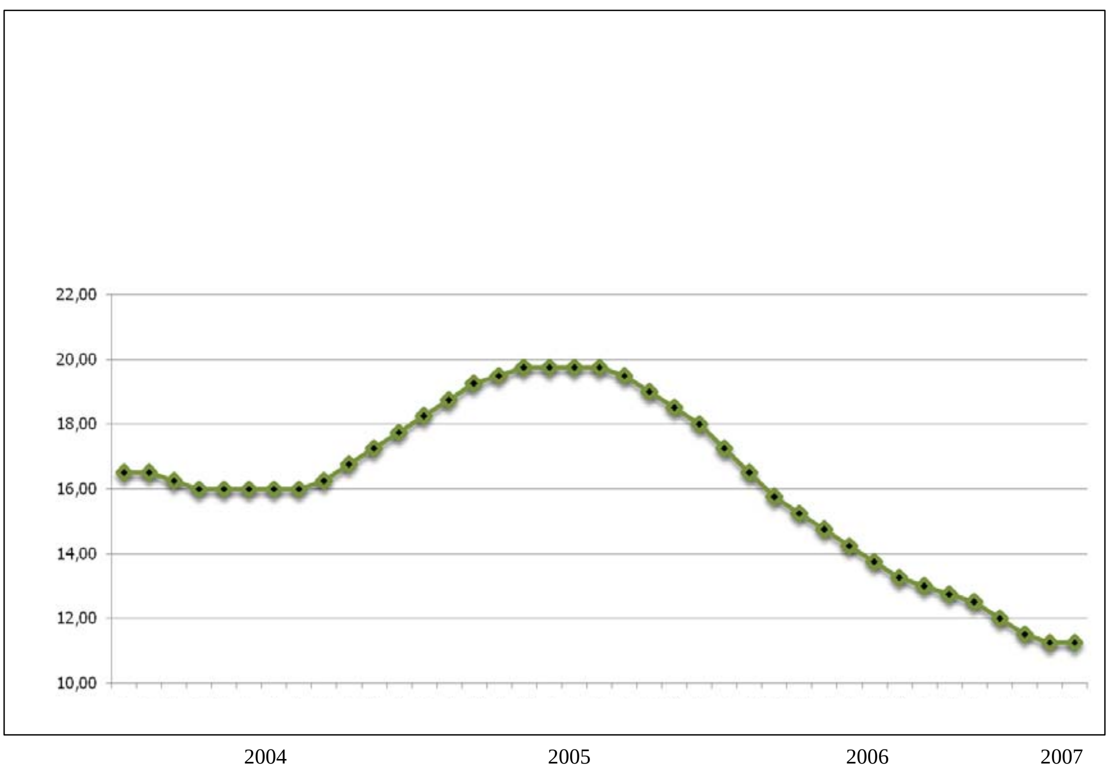
Funding

The funding risks to be faced in Brazil are the same as those in the US, with the addition of currency risk, depending on how the lessor's transactions are denominated. Nowadays, the Real has been gaining value vis-à-vis the US dollar, and therefore, funding in US dollars is becoming less expensive than in the past.

Due to economic policy issues, the domestic interest rates in Brazil were held very high in the past, in order to control and prevent inflation. This situation used to create a big challenge for funding, namely, making funds in the local currency extremely expensive, with gaps between domestic and international rates of over 1,000 basis points. Under the current government, the economic policy has achieved the goal of reducing domestic interest rates, as shown in **Exhibit Three**.

Exhibit Three

Domestic Interest Rates



Even so, there still is a gap between domestic rates in Brazil and international capital market rates. In the past, the hedge market has leveled the field. However, any fluctuation in such markets will certainly impact the actual availability and cost of funding and needs to be managed with a very solid funding risk culture.

Another sub-category of funding risk is the liquidity risk, i.e., the risk that at a certain point cash and short term assets may not be enough to cover short term liabilities. Every month, upon electronic submittal of financial statements by SAMs and Banco Multiplos, the Central Bank carefully reviews this risk, constantly requiring all financial institutions (including lessors) to either match the maturities of their assets and liabilities or hedge their liquidity risk exposures. The Brazilian market also offers the possibility to hedge liquidity risks, through derivatives traded in the BM&F exchange market.

Credit

Credit risk always is of primary concern whenever a leasing and finance company enters a new market. When doing business with listed companies (which, generally, are only the larger companies in Brazil) the best source of information is a firm's filings with the stock exchange. Credit reporting agencies, such as Serasa, have existed for many years, although the information provided is not yet comparable with what is available in the US, as the coverage is not very comprehensive, both in terms of quantity as well as in quality.

Data gathered by the World Bank indicates that, while the private credit bureau (Serasa) covers 46.4% of the population (approximately 56 million individuals and 4 million companies), the public credit bureau (managed by the Central Bank) covers only 17.1% of the target population (approximately 21 million individuals and 2.2 million companies).[22]

On the other hand, due to legal restrictions, private credit bureaus are not allowed to disclose, prima facie, negative information about debtors, and the process of reporting to Serasa is constantly challenged by constitutional injunctions, some of which are justified and some of which are frivolous. In addition, information tracking the payment habits of customers for more than two years is not readily available.

Credit performance, in many cases, also is specific to each industry segment. Currently, delinquency rates are very low in Brazil, although the credit loss indicators are not consistent depending on the market niche of the lessor. For instance, according to studies made by The Alta Group in Brazil, while certain lessors suffer very low losses such as 0% (IBM Leasing), 0.009% (Safra Leasing) and .12% (Bradesco), others report credit losses between 1%

[22] World Bank, "Doing Business 2008"

(Itauleasing, the largest lessor) and 2.6% (BB Leasing, the government-owned lessor).[23]

The captives have advantages in this regard because they know their customers very well due to their dealer networks and time in the market. Independent lessors wishing to lease to the small/medium business segment will need to invest a significant amount of time studying the local market, and, more importantly, developing personal customer relationships.

Residuals

Residual management has been developed in the motor vehicle markets. In addition to the operating leases offered for motor vehicles, there are many solid players in the rental (locacão) marketplace. The largest lessor in the locação market is a Brazilian company called Localiza, a multinational lessor whose business model is based on the retention of residual risks.

The above notwithstanding, residual management is very poor in other areas of equipment leasing. Furthermore, the Central Bank demands that lessors that increase their operating leasing portfolios must have solid and reliable residual risk management processes and systems, which places limits on the growth of this market. Given the large size of the economy and concomitant secondary markets, however, the opportunities to generate upside gains and capture market share in operating leases is clearly open in Brazil.

Structuring

Many multinationals doing business in Brazil (as mentioned before, Brazil receives the 14th largest inflow of foreign investments worldwide), demand creative lease structures. Many companies need to allocate operating expense budgets to their use of capital goods, while others need finance lease structures. This represents an opportunity for those lessors that have structuring capabilities and can get comfortable with lessees' credit positions.

Legal/Documentation

Although leasing in Brazil is more than 40 years old, several issues rooted in the civil law system still make it highly advisable to rely upon competent legal counsel. First and foremost, there is not a reliable, publicly available recording system for personal property such as exists in the US. Moreover, Brazil has not yet ratified the Cape Town Convention[24]; therefore, public on-line registrations for

[23] The Alta Group: Panoramica del Leasing en América Latina. Presentation at the V Latin American Leasing Conference, Miami, November 8-9, 2007. Presentation available at www.thealtagroup.com

[24] The Cape Town Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, together usually referred to as the Cape Town Treaty, is an international treaty intended to standardize

equipment are not part of the day-to-day practice of leasing and finance companies.

Second, the courts occasionally come out with surprising interpretations of the law, usually triggering remedial action by ABEL. Recent examples include the case law about enforceability of foreign exchange adjustment clauses that emerged after the 1999 foreign exchange crisis, and the 2002 court decision ruling that advance payments of the guaranteed residual value defease the lease, thereby converting it into a conditional sales agreement. This issue was resolved favorably for the industry by a Supreme Court decision issued in 2004[25].

In certain regions, in particular where there is no solid leasing culture, i.e., the North and the Northeast, and partially in the Southern region, the courts tend to correlate commercial equipment leasing to consumer financing. This is random in the country, but the risk exists.

Collections

Collections are certainly a challenge in Brazil just as in the US. However, the system and its infrastructure have evolved in a favorable manner. The risk of collections in Brazil must be minimized by gathering reliable information about lessees, their industries, and their cash flows. In the last 10 years, Brazilian lessors have improved their credit and collection practices and there are several players offering collection services with proven efficiency.

Repossession and recourse

The enforceability of lease agreements is widely recognized in Brazil, although the system is far from efficient. The components necessary to enforce leasing transactions include the rule of law, the efficiency of the legal system, and a corruption-free environment. The first component, the rule of law, refers to the overall likelihood of prompt payments and voluntary repossessions, and is based on past practices and recognition of the legal obligation to make payments.

The second factor to be considered is the efficiency of the court systems in Brazil, particularly in connection with collection and repossession risks. If

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transactions involving movable property, particularly aircraft and aircraft engines. The Luxembourg Protocol extended its scope to railway equipment. The treaty creates international standards for registration of ownership, security interests (liens), leases and conditional sales contracts, and various legal remedies for default in financing agreements, including repossession and the effect of particular states' bankruptcy laws.

[25] The prevailing legal interpretation sets forth that, in a finance lease transaction, the parties define who assumes the residual risk, and the lessor agrees to assume it. Therefore, lessee and lessor are legally entitled to set forth cash collaterals to secure the residual value guaranty, and that such cash collaterals may not be construed as advances to the purchase option price, since, at the inception of the lease, the lessee has not yet made up its mind as to whether or not it will exercise such purchase option.

negotiations do not succeed, for whatever reason, going to court must be an effective alternative if lessors are to have confidence in the system. Unfortunately, in Brazil going to court is not necessarily an efficient alternative for enforcing the lessor's rights, particularly in smaller cities and locales.

Brazil ranks 106 among 178 countries rated by the World Bank as to the effectiveness of the legal process. In average, it takes 616 days to enforce a contract and it takes 45 procedures to do so[26], which is a combination of the inefficiency of the courts and corruption. This indicator has been closely confirmed by the practitioners interviewed. The landscape of corruption in Brazil can be seen in **Exhibit Four**, which is published by Transparency International.

Exhibit Four

Corruption Index

Country Rank	Regional Country Rank	Country /Territory	CPI Score 2007	Confidence Intervals	Surveys Used
9	1	Canada	**8.7**	8.3 - 9.1	6
20	2	USA	**7.2**	6.5 - 7.6	8
22	3	Chile	**7.0**	6.5 - 7.4	7
23	4	Barbados	**6.9**	6.6 - 7.1	4
24	5	Saint Lucia	**6.8**	6.1 - 7.1	3
25	6	Uruguay	**6.7**	6.4 - 7.0	5
30	7	Saint Vincent and the Grenadines	**6.1**	4.0 - 7.1	3
37	8	Dominica	**5.6**	4.0 - 6.1	3
46	9	Costa Rica	**5.0**	4.7 - 5.3	5
61	10	Cuba	**4.2**	3.5 - 4.7	4
67	11	El Salvador	**4.0**	3.2 - 4.6	5
68	12	Colombia	**3.8**	3.4 - 4.3	7
72	13	Suriname	**3.5**	3.0 - 3.9	4
72	13	Mexico	**3.5**	3.3 - 3.8	7
72	13	Peru	**3.5**	3.4 - 3.7	5
72	13	Brazil	**3.5**	3.2 - 4.0	7
79	17	Grenada	**3.4**	2.0 - 4.1	3
79	17	Trinidad and Tobago	**3.4**	2.7 - 3.9	4
84	19	Jamaica	**3.3**	3.1 - 3.4	5
94	20	Panama	**3.2**	2.8 - 3.4	5

[26] World Bank. "Doing Business 2008".

One of the critical challenges for enforcing lessors' rights resides in the fact that lessors which have enforced their repossession rights are prevented from pursuing avenues to garnish other assets of the lessee until due diligence is made to sell the repossessed asset for its fair market value. Only after applying the sales proceeds to the outstanding debt is the lessor entitled to seek other assets to collect the outstanding debts.

Competition

In Brazil, the competitive environment is wide-ranging and diverse, and the market is still quite open, as is market entry. Cash currently is the primary competition, although banks also represent formidable competition, especially for large companies that have access to inexpensive bank loans. Competition amongst lessors also is very wide and there are dominant players in the marketplace according to data released by ABEL. **Table III** shows the 20 largest finance lessors in Brazil, along with their corresponding market share.

Table III
Largest Finance Lessors

POSITION	COMPANY	TOTAL US$m	CONTRACTS	SHARE%
1	Cia .Itauleasing de Arrendamento Mercantil	7,465,787,075	808,069	32.85
2	Banco Itaucard S/A Arrendamento Mercantil	2,421,432,832	240,149	10.65
3	Safra Leasing S/A Arrendamento Mercantil	2,291,661,974	67,273	10.08
4	Dibens Leasing S/A Arrendamento Mercantil	1,709,987,408	82,194	7.52
5	Bradesco Leasing S/A Arrendamento Mercantil	1,572,151,785	36,149	6.92
6	Sudameris Arrendamento Mercantil S/A	1,085,170,463	78,14	4.77
7	Banco Finasa S/A - Carteira Arrendamento Mercantil	982,259,487	104,312	4.32
8	HSBC Bank Brasil S/A Arrendamento Mercantil	684,679,852	47,766	3.01
9	Banco IBM S/A Arrendamento Mercantil	606,579,389	617	2.67
10	ABN Amro Arrendamento Mercantil S/A	630,033,589	30,11	2.77
11	BB Leasing S/A Arrendamento Mercantil	595,733,687	14,517	2.62
12	DaimlerChrysler Leasing Arrendamento Mercantil S/A	563,783,125	9,655	2.48
13	Banco Itaú S/A	249,842,387	39,284	1.10
14	Panamericano Arrendamento Mercantil S/A	241,467,447	111,017	1.06
15	Itaubank Leasing S/A Arrendamento Mercantil	248,184,752	3,275	1.09
16	Alfa Arrendamento Mercantil S/A	218,876,142	6,819	0.96
17	HP Financial Services Arrendamento Mercantil S/A	217,080,385	789	0.96
18	Banco Commercial I.Trust do Brasil S/A - Banco Múltiplo	187,567,842	4,646	0.83
19	Santander Brasil Arrendamento Mercantil S/A	181,222,486	14,401	0.80
20	Volkswagen Leasing S/A Arrendamento Mercantil	195,516,075	7,882	0.86
	Total of the market	**22,726,096**	**1,726,198**	**100%**

Financial risk

The leasing and financing business, by definition, has a high degree of risk associated with it. Understanding those risks, in the context of the Brazilian market, is an essential element of expanding into this leasing market.

Interest rates

Forward contracts are readily available to Banco Multiplos in Brazil to hedge against interest rate movements for lessors borrowing in Reals.

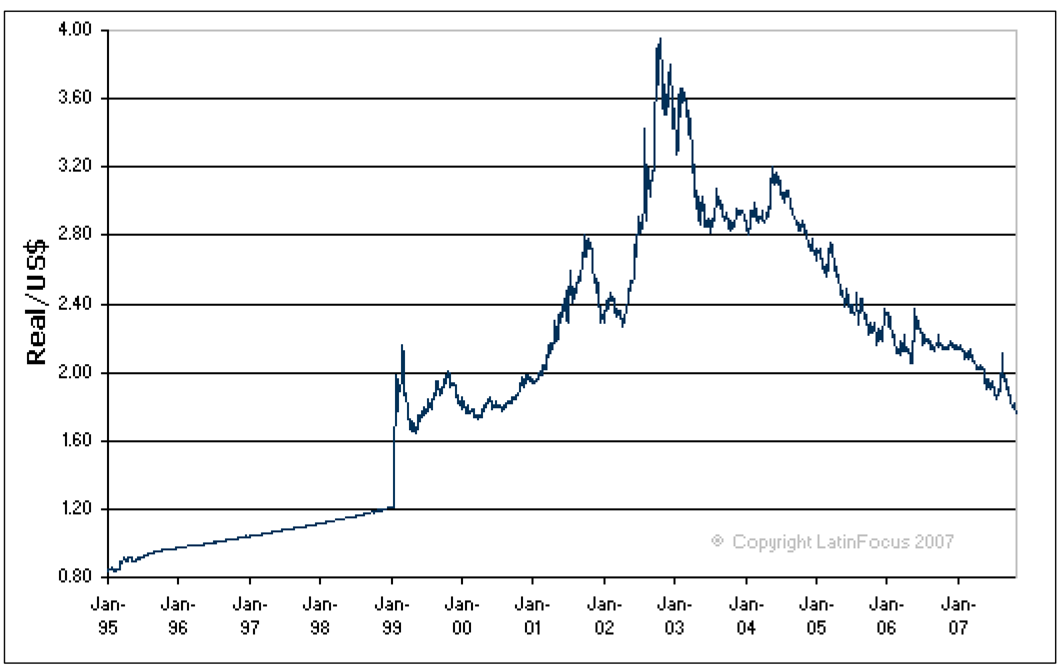
Currency

Lessors and equipment financiers face currency risk not only in their ongoing operations if the rentals are denominated in local currency, but also at the end of the lease. At the time of liquidation, for example, they will need to convert the proceeds in local currency into a hard currency such as US dollars or Euros.

Both on transactional and institutional levels, Brazilian Real hedges are available through the banking system and the Futures and Commodities Exchange operating in Brazil. On a more global basis, the Brazilian currency floats, following the guidelines set forth by the International Monetary Fund. **Exhibit Five** shows the fluctuation of the Brazilian Real over the last 13 years:

Exhibit Five

Real/US$ Exchange Rate



The key question to ask, of course, is "How volatile is the Brazilian Real?" According to the International Monetary Fund:

> "Fast export growth has underpinned sustained external current account surpluses which, together with strong private capital inflows, have allowed the authorities to build a comfortable cushion of foreign exchange reserves. Brazil's trade surplus remained high in 2006, at 4⅓ percent of GDP, and export volumes picked up in the first part of 2007. With declining country risk premia, still relatively high interest-rate differentials, and reduced exchange rate volatility, capital inflows, including foreign direct investment, have risen. In that context, official international reserves have more than doubled over the past 12 months.
>
> The fiscal accounts remain strong, despite some weakening in the primary surplus in 2006. After reaching a record-high of 4.4 percent of GDP in 2005, the primary fiscal surplus declined to 3.9 percent of GDP in 2006. However, strong revenue collections have raised the surplus in early 2007. For the year as a whole, the government plans to step up capital outlays under the Pilot Investment Program, to help address infrastructure needs. Owing to a falling interest bill, the overall deficit of the public sector is expected to decline in 2007."[27]

The Economist magazine has created a purchasing power index called the Big Mac index, which measures the equivalent purchasing power of a currency. The latest release of this index indicated a close parity between the Brazilian Real and the US dollar. This indicator must be assessed carefully, though, because a large portion of Brazil's exports are to European and other markets whose currencies have been appreciating at the expense of the US dollar. Even so, the currency risk in Brazil is more predictable than in several other markets, and the system has diverse hedge instruments available. **Exhibit Six** shows the Brazilian Big Mac as of July, 2007.

Interest remittance, royalties and profit repatriation

In 2005 the Central Bank introduced a new administrative regime for foreign currency transactions. The new regulations unified the foreign exchange market and removed many restrictions associated with remittances overseas such as, for example, requiring prior Central Bank approval for contracting loans in another country. The Central Bank has, however, maintained reporting requirements on all foreign exchange transactions, through a centralized registry called the ROF. In a related effort, the Central Bank is working to streamline the regulatory regime for foreign investment transactions in Brazil.

[27] IMF Executive Board Concludes 2007 Article IV Consultation with Brazil. Public Information Notice (PIN) No. 07/114, September 18, 2007, available at: http://www.imf.org/external/np/sec/pn/2007/pn07114.htm.

Exhibit Six

Big Mac Index

	Big Mac prices In local currency	Big Mac prices in dollars	Implied PPP* of the dollar	Actual dollar exchange rate Jan 31st	Under (-)/over (+) valuation against the dollar, %
United States†	$3.22	3.22			
Argentina	Peso 8.25	2.65	2.56	3.11	-18
Australia	A$3.45	2.67	1.07	1.29	-17
Brazil	Real 6.4	3.01	1.99	2.13	-6
Britain	£1.99	3.90	1.62‡	1.96‡	+21
Canada	C$3.63	3.08	1.13	1.18	-4
Chile	Peso 1,670	3.07	519	544	-5
China	Yuan 11.0	1.41	3.42	7.77	-56
Colombia	Peso 6,900	3.06	2,143	2,254	-5
Costa Rica	Colones 1,130	2.18	351	519	-32
Czech Republic	Koruna 52.1	2.41	16.2	21.6	-25
Denmark	DKr27.75	4.84	8.62	5.74	+50
Egypt	Pound 9.09	1.60	2.82	5.70	-50
Estonia	Kroon 30	2.49	9.32	12.0	-23
Euro area§	€2.94	3.82	1.10**	1.30**	+19
Hong Kong	HK$12.0	1.54	3.73	7.81	-52
Hungary	Forint 590	3.00	183	197	-7
Iceland	Kronur 509	7.44	158	68.4	+131
Indonesia	Rupiah 15,900	1.75	4,938	9,100	-46
Japan	¥280	2.31	87.0	121	-28
Latvia	Lats 1.35	2.52	0.42	0.54	-22
Lithuania	Litas 6.50	2.45	2.02	2.66	-24
Malaysia	Ringgit 5.50	1.57	1.71	3.50	-51
Mexico	Peso 29.0	2.66	9.01	10.9	-17
New Zealand	NZ$4.60	3.16	1.43	1.45	-2
Norway	Kroner 41.5	6.63	12.9	6.26	+106
Pakistan	Rupee 140	2.31	43.5	60.7	-28
Paraguay	Guarani 10,000	1.90	3,106	5,250	-41
Peru	New Sol 9.50	2.97	2.95	3.20	-8
Philippines	Peso 85.0	1.74	26.4	48.9	-46
Poland	Zloty 6.90	2.29	2.14	3.01	-29
Russia	Rouble 49.0	1.85	15.2	26.5	-43
Saudi Arabia	Riyal 9.00	2.40	2.80	3.75	-25
Singapore	S$ 3.60	2.34	1.12	1.54	-27
Slovakia	Crown 57.98	2.13	18.0	27.2	-34
South Africa	Rand 15.5	2.14	4.81	7.25	-34
South Korea	Won 2,900	3.08	901	942	-4
Sri Lanka	Rupee 190	1.75	59.0	109	-46
Sweden	SKr32.0	4.59	9.94	6.97	+43
Switzerland	SFr6.30	5.05	1.96	1.25	+57
Taiwan	NT$75.0	2.28	23.3	32.9	-29
Thailand	Baht 62.0	1.78	19.3	34.7	-45
Turkey	Lire 4.55	3.22	1.41	1.41	nil
UAE	Dirhams 10.0	2.72	3.11	3.67	-15
Ukraine	Hryvnia 9.00	1.71	2.80	5.27	-47
Uruguay	Peso 55.0	2.17	17.1	25.3	-33
Venezuela	Bolivar 6,800	1.58	2,112	4,307	-51

There has been a relaxation since 1991 of the restrictions on the remittances of royalty payments for patent and trademark use between subsidiaries established in Brazil and the parent office headquartered overseas and also on remittances of franchise contract royalties. A 1992 INPI resolution simplified procedures and, in particular, eliminated a number of requirements concerning technology transfer agreements. No royalties or other fees may be transferred between related companies for the use of software.

There are few restrictions on converting or transferring funds associated with an investment. Foreign investors may freely convert Brazilian currency in the foreign exchange market wherein buy-sell rates are determined by market forces. All foreign exchange transactions, including identifying data, must be reported to the Central Bank, however. Foreign-exchange transactions on the current account have been fully liberalized in practice.

Foreigners investing in Brazil must register their investment with the Central Bank within 30 days of the inflow of resources to Brazil. Registration is done electronically. Investments involving royalties and technology transfer must be registered with the patent office as well. Investors must have a representative in Brazil and register with the Brazilian securities commission (CVM). Subsequent transactions, such as reinvestment of profits, also may have to be registered with the Central Bank.

Foreign loans obtained abroad no longer require advance approval by the Central Bank, provided the recipient is not a government entity (loans to government entities still require prior approval from Central Bank as well as the Finance Ministry Treasury Secretariat). Upon concluding the transaction, the loan must be registered electronically with the Central Bank. In most instances, the registration is completed automatically. Automatic registration is not issued when the costs of the operation are “not compatible with normal market conditions and practices.” In such instances, the loan is reviewed by the Central Bank, although if the Central Bank does not respond within five working days, the registration is deemed complete.

Interest and amortization payments specified in the loan contract can be made without additional approval from the Central Bank. That also applies to early payments, if there is a provision in the contract for early payment. If the contract does not have such a provision, early payment requires prior approval by the Central Bank.

Tax

Capital gain remittances are subject to a 15% income withholding tax, with the exception of the capital gains and interest payments on domestically-issued Brazilian bonds, which became tax-exempt in February 2006.

Repatriation of an initial investment also is exempt from income tax. Beginning in 2000, lease payments were assessed a 15% withholding tax. Remittances related to technology transfers are not subject to the tax on credit, foreign exchange, and IOF, although they are subject to a 15% withholding tax and an extra 10% Contribution of Intervention in the Economic Domain (CIDE) tax. Loans with terms of 90 days or less must pay the IOF (5%), while those of longer maturity do not.

Brazil has no double taxation treaty with the US, but does have such treaties with Germany, Ecuador, Italy, Argentine, Spain, Japan, Austria, the Philippines, Luxembourg, Belgium, Finland, Norway, Canada, France, Portugal, China, the Netherlands, Czech Republic, South Korea, Hungary, the Slovak Republic, Denmark, India, and Sweden. These treaties provide lower effective tax rates.

Capital investment

Repatriation of capital is not restricted at all, provided that all taxes have been paid. Repatriation of capital may come from either the proceeds of the liquidation of the company or the proceeds of the sale of the stock.

From a sovereign risk perspective, Brazil is considered to be just one notch below investment grade with a general consensus that it will become an investment grade country in a relatively short period of time.

Exit strategy risk

The process of ceasing operations in Brazil is similar to that in most other countries. This process involves filing documents with the appropriate government authorities, submitting audited financial statements and bank records, settling with partners, and paying any debts and taxes due.

As mentioned, once the exit proceeds, either through a sale or liquidation of a company, are due, the repatriation process is quite simple, assuming prior compliance with the tax and foreign exchange requirements.

Case Studies

Research was conducted with three separate lessors in an effort to learn more about the realities of equipment leasing in Brazil. These lessors are either currently active, or were so in the past. Diverse lessors were incorporated as part of the case studies in order to glean a variety of experiences, and included:

- An international technology company whose Brazilian leasing activities are conducted by a wholly-owned leasing company.

- An independent, US-based lessor that writes both offshore leases into Brazil and has a wholly-owned Brazilian lessor.

As part of the research, interviews were conducted in which each lessor was asked details about its background (including parent, if appropriate), its leasing operations in Brazil, the decision process used to enter the market, any experience gained, and lessons learned. The various case studies can be found on the following pages:

US Captive Lessor

Company Background

The IT captive, headquartered in the United States, has offices in more than 40 countries. With a global leasing and finance portfolio of over US$ 8.3 billion and over 1,300 employees worldwide, this is one of the most effective captives serving the customer financing needs of its parent company.

The company started doing business in Brazil at the beginning of the nineties, through a succession of companies licensed as lessors by the Central Bank. These lessors later came under the control of this company as the result of a merger with its parent. As a result, the group kept two leasing licenses and allowed one of them to expire.

Description of Financing Operations in Brazil

- **Organization** – The company operates a Sociedad de Arrendamento Mercantil leasing company, or SAM, duly licensed by the Central Bank of Brazil. It has accumulated, as of the latest reported date, a leasing portfolio of over R$520 million (more than US$260 million). In addition and according to the extended practice within the industry, the company has a rental company, or *locadora*, which is not subject to the control of the Central Bank. As such, it does not have the benefits and burdens of such supervision, but does operate under the strict control and guarantee of the parent.

  The role of the rental company is to structure and book deals that require special structures that do not fit into the guidelines of the Central Bank, such as software financing, special loans, and related transactions. It was not possible to ascertain the value of the portfolio of the rental company, though it can be estimated that its total portfolio is less than 50% of the leasing company's portfolio.

- **Employees** – Since the Brazilian operation also acts as the hub for the Southern Cone (Brazil, Argentina, Chile, Uruguay, and Paraguay), the employees of the company oscillate between 50 and 100, although it is estimated that there are no more than 25 dedicated full time employees for the Brazilian operation.

- **Business Model** – The group exists mainly to support its parent's and its distribution channels' (value-added resellers and distributors) customers with equipment leasing requirements in Brazil. The leases booked by the company are primarily to large customers, and may involve some other OEM equipment, besides that manufactured by the parent. According to Central Bank published data, the company has close to 83% of its total portfolio concentrated in its 10 largest customers. The platform for small ticket financing is outsourced with one of the largest Brazilian banks.

- **Credit** – Overall, credit decisions are compatible with the prevailing credit standards of the company's parent. Local management has credit authority of up to US$1 million. Transactions with larger exposure are submitted to the regional offices.

- **Funding** – All funding is provided by the parent company. The parent has very solid cash holdings and considers that the best use of its cash is to fund its captive. Since all the funding is denominated in US dollars (except a low balance of tax-driven, intercompany debt funded in Euros through the Netherlands), the local treasury is very active in hedging its positions. The company's published financials clearly indicate use of derivatives to cover exchange rate fluctuations, interest rate fluctuations, and liquidity mismatches.

Decision Process to Enter the Brazilian Leasing Market

- **Drivers** – The parent's desire to enter the Brazilian leasing market was driven both by the need to service its customers and by the huge market size. Brazil is one of the fastest growing countries in information technology and the popularity of hardware and software is one of the highest in the world.

- **Decision Process** – The decision process is one of continuous evolution. One of the predecessors of the current parent entered Brazil through a vendor program arrangement with a company that obtained the license, built a portfolio, and then exited the leasing business. This forced the captive to purchase the Brazilian company and its portfolio in Brazil, becoming one of the leaders in IT financing. When the parent's merger took place, the captive kept the license and the operations that were acquired by its predecessor. Ultimately the decision to keep an active presence in Brazil has proven worthwhile, though it might be characterized as more accidental than strictly planned.

Experience

- **Volumes** – Annual lease origination volumes are in the range of US$80 to US$100 million. Leased assets include IT and telecom equipment, and other manufacturing-related assets.

- **Bad debt and delinquencies** – The interviewee described bad debt levels as very low and expressed great satisfaction with the collection tools existing in Brazil. In particular, the use of the credit bureaus' reporting mechanisms has proven one of the most effective tools, since large customers cannot afford the risk to their reputation associated with bad payment habits. In addition, experience at court has proven to be good, while the need to go to court was very limited. The only bankruptcy that the company has experienced (a Chapter 11 reorganization) was favorably decided in a reasonably short time.

- **Personnel** – The company is highly satisfied with the Brazilian talent, in particular around the south of the country where there is a relative large number of well-trained young professionals with good skills in three languages (Portuguese, Spanish, and English). This is one of the reasons why the company decided to use Brazil as a hub.

US Independent Lessor

Company Background

The independent leasing company, headquartered in the US, has more than one million customers in over 50 countries. With a global leasing and finance portfolio of over US$75 billion and over 10,000 employees worldwide, this is one of the largest independent leasing and financing companies serving the customer financing needs of equipment vendors.

The company started doing business in Brazil during the second half of the nineties, by incorporating a non-regulated locadora, and by acquiring an existing leasing company that held a license granted by the Central Bank. Since this acquisition was subject to approval by the Central Bank, the company entered into an operating agreement with an existing lessor to originate deals and book them for the account of the other lessor, with a right to purchase the portfolio once the license was granted. The structure of the operating agreement enabled the company to keep its expected pretax gain, while paying a fee to the host company. This was a fortunate event, since the existing lessor was not originating business of its own.

Description of Financing Operations in Brazil

- **Organization** – The company operates on three fronts. Domestically, it originally operated through a Sociedad de Arrendamento Mercantil leasing company, or SAM, licensed by the Central Bank. In the last couple of years, this company was converted into a Banco Multiplo. It has accumulated, as of the latest reported date, a leasing portfolio of over R$495 million (more than US$247 million).

  In addition, and in line with industry practice, the company has a rental company, or locadora, which is not subject to the control of the Central Bank. As such, it does not have the benefits and burdens of such supervision, but does operate under the strict control and guarantee of the parent. The role of the rental company is to structure and book deals that require special structures that do not fit into the guidelines of the Central Bank. Examples include operating leases that go beyond the definitions of the Central Bank or require special structuring, special loans, and related transactions. The value of the portfolio of the rental company is estimated at over US$10.4 million.

The company also operates cross border leases between the US and Brazil, generating volumes that are almost as large as the domestically booked portfolio. The current cross-border lease portfolio is $US26.1 million, while the total Brazilian portfolio of this company exceeds US$288 million.

- **Employees** – The company operates with approximately 70 full time employees. There are 20% of the employees in sales, 30% in credit and operations, 20% in finance, treasury, and accounting, 8% in MIS, 20% in the small ticket platform, with the remainder in top management. A large percentage of the employees are bilingual and trained in dealing with US capital markets reporting and compliance (Sarbanes-Oxley, US GAAP reporting, etc.)

- **Business Model** – The group exists mainly to support its strategic vendors and has been developing a unique platform in IT financing. In the last couple of years, it has expanded its reach to become a relevant player in significant leasing transactions in Brazil.

- **Credit** – Overall, credit decisions are compatible with the prevailing credit standards of the company's parent. Local management has credit authority of up to US$2 million and deals with larger exposure are submitted to the regional offices. Credit decisions over US$5 million must be approved by the parent. This credit authority organization has proven to be one of the most solid of any multinational doing business in Brazil.

- **Funding** – All funding is provided by the parent company. The parent has ample access to the US capital markets and can raise funds below the average cost of funds prevailing in the borrowing markets in Brazil. Recently, since interest rates in Brazil have been declining and the cost of hedges has grown, the Banco Multiplo is exploring the use of the CDI as a funding tool. No significant funding has been provided by the CDI so far, however. The company's published financials indicate the use of derivatives to cover exchange rate fluctuations, interest rate fluctuations, and liquidity mismatches.

Decision Process to Enter the Brazilian Leasing Market

- **Drivers** – The parent's desire to enter the Brazilian leasing market was driven both by the need to service its vendor's customers and by the country's huge market size. Brazil is one of the fastest growing countries in capital investment in industries such as information technology, office equipment, transportation equipment, healthcare financing, and infrastructure financing.

- **Decision Process** – The decision process was the result of a business plan that was aggressively sold at one of the predecessors of this large multinational, which built one of the largest vendor financing and leasing companies worldwide.

Experience

- **Volumes** – Annual lease origination volumes are in the range of US$140 to US$150 million. Leased assets include IT, telecom equipment, construction equipment, healthcare, office equipment, transportation equipment, software, and IT related assets.

- **Bad debt and delinquencies** – Bad debt levels are very low. The company keeps permanent credit surveillance through its Latin American regional office, which controls the processes, manages problem solving and reports to the headquarters.

- **Personnel** – The company is highly satisfied with the Brazilian talent, particularly in the areas of finance, treasury, and credit. The quality of the professionals is outstanding. Sales personnel require continuous training that is intended to be provided on a permanent basis, subject to overall budget restrictions.

- **Other considerations-** The management of the company noted some worrisome features of the Brazilian leasing market, one of which is the large market concentration (four players control more than 60% of the market). Other concerns include the large concentration of vehicle leasing, which leaves little room for other assets, the lack of skills in secondary markets and asset management, and the tendency of consumers to use leasing, which places commercial lessors in competition with the consumer lending products. Lastly, the heavy tax burden affects not only the company, but also attaches potential liability to its managers.

Conclusion

The Brazilian economy not only is one of the fastest growing in the world, but also has a very international flavor. Lessors seeking expansion opportunities, therefore, must give thought to the Brazilian market, particularly those with ambitious growth goals. Equipment leasing emerged in Brazil in the mid 1960s, so it has a long history and is well accepted. This is not to say that, like leasing industries everywhere, it has not had its share of challenges and will not continue to face more. It is critical, therefore, that lessors be armed with adequate and accurate information regarding the opportunities and pitfalls in this market.

Many of the risks lessors face in Brazil are the same as those in the US, except they are compounded by time and distance. There also are uniquely Brazilian challenges. For example, although there are established leasing laws, and a strong legal system is in place, enforcement of contracts can be problematic outside of the major population centers. Other major differences between the US and Brazil include language, culture, and the number and nature of business regulations.

Many international lessors with operations in Brazil today have Brazilian partners. Although it is not mandatory to do so, the much lower paid-in capital requirements and expertise these partners can bring to the operation can be invaluable. In addition, foreign investment in new or existing leasing companies normally requires a Presidential Decree to be approved.

Investing in the Brazilian leasing market can be a sound decision for lessors whose customers are asking for leases there and who can effectively manage the risks. This investment, however, will require a significant and ongoing commitment. Although companies do not enter markets with a plan to leave, a sound exit strategy also should be a part of the investment plan. On the positive side, experience has shown that the exit and repatriation process is quite simple, assuming prior compliance with the tax and other regulations.

The key to success, therefore, is to carefully consider the unique risks inherent in Brazil. Although the analysis may not be much different than one performs in entering any new market, it is important to remember that the differences in culture, economy, time, and distance magnify the risks, concerns, and operating issues of conducting leasing and finance activities in Brazil.

Appendix One – Domestic Leasing Guidelines

- The Central Bank of Brazil is responsible for authorizing the establishment and operation of Banco Multiplos, commercial banks, investment banks, development banks, consumer finance companies, real estate finance companies, mortgage credit companies, development agencies, SAMs, securities brokers, securities dealers, and foreign exchange brokers.

- Direct controlling interests in the institutions listed above may only be held by:

    1. Natural persons
    2. Financial institutions and other institutions authorized to operate by the Central Bank of Brazil
    3. Other legal entities whose sole purpose is to invest in the equity of financial institutions and other institutions authorized to operate by the Central Bank (holding companies)

- In order to request authorization to establish a financial institution in Brazil, the organizing group must appoint a technically qualified person as a contact with the Central Bank in regards to the clarification of any issue related to the project. In addition, members of the future controlling group and qualified shareholders, i.e. those that own more than 5% of total capital, must be identified.

- All members of the future controlling group and qualified shareholders must authorize the Central Bank to obtain full access to their income tax data relating to the last three fiscal years, for the sole purpose of usage for authorization proceedings. The Central Bank also must be authorized to access information regarding the inventory of properties and rights and debts and mortgages. The absence of restrictions on the personal data mentioned above is essential to obtain the Central Bank's authorization for the operation of a financial institution in Brazil.

- The Central Bank, when it deems necessary, may require the publication of a statement of purpose by naturals and legal entities that form part of the controlling group of the financial institution.

- A detailed economic and financial feasibility analysis report must be made available to the Central Bank, containing at least a three year forecast of the financial institution's operations. It must comprise the following data:

    1. Market analysis, describing in what market segments the financial institution will be focusing on;

2. It must include a per market segment analysis of the opportunities, weaknesses, threats and strengths of the institution in comparison to other competitors;
3. For each market segment, the application must describe the main premises used in the business plan, such as growth rate, customers income, interest rate and so on; and
4. Capital structure to be adopted by the financial institution, indicating the source of funds and assets/liabilities evolution over time.

- A detailed business plan must be made available to the Central Bank, containing at least a three year forecast of the financial institution's operations. It must comprise the following data:

1. Organizational structure, clearly indicating the responsibilities and attributions of each organizational level;
2. Description of the main procedures for controlling risks associated with the financial institution's operations, such as operational risk, credit risk and market risk;
3. Internal and external auditing procedures and specifications;
4. Strategic goals;
5. Definition of main products and services to be provided and public targeted;
6. Specification of the information technology infrastructure necessary to provide the desirable products and services to customers and to assure full compliance with the risk management policies to be adopted by the financial institution;
7. Definition of the time frame needed to initiate activities after authorization has been granting by the Central Bank; and
8. Description of the criteria to be utilized for selecting top management.

Appendix Two - Scope Of FINAME

FINAME is a government sponsored credit facility managed by the National Bank of Economic Development (BNDS) to provide subsidized funding to such financial institutions that provide equipment financing, including equipment leasing. The following are the basic guidelines of the FINAME's facility and indicates the conditions to access such facility:

Financeable projects and endeavors

- Implantation, amplification, recovery and modernization;
- Innovation and technological development;
- Production, trade, import and export of goods and services;
- Internationalization of domestic capital companies (provided that associated to promotion of Brazilian exports);
- Sectorial/Corporate restructure (always through mechanisms of the capital market, except in the projects of auto-managing companies);
- Investments in urban and social infrastructure;
- Companies' social investments;
- Endeavors related to the pig iron manufacturing sector, subject to timber and coal used as energy and raw material in the companies' production process, come from reforestation (evidenced through a Custody Chain Certificate); and
- Endeavors in the sectors of radio broadcasting, newspapers and periodicals, means of communication and publicity in general, only through indirect and non-automatic operations.

Items that are financeable

General

- Civil works, assembly and installations;
- New machinery and equipment, including industrial groups and systems produced in Brazil and contained in BNDES Accrediting for Computerized

Manufacturers [CFI], presenting a nationalization index, in value, equal or over 60% (sixty per cent), or fulfilling the Basic Productive Process [PPB];

- Used machinery and equipment, domestically manufactured, only to micro enterprises;

- Furniture and fixture, not separately;

- Import of machines and new equipment, without national similarity, only for companies of the industrial sector (Sections “B” and “C” of the CNAE 2.0 of the IBGE);

- Expenses arising from nationalization of imported equipment, provided that do not imply in remittance of foreign currencies, even in case the import is not financed by BNDES;

- Expenditures with engineering studies and projects related to the investment;

- Expenditures with: Quality and Productivity, Research and Development, Technical and Managerial Qualification, Technological Updating and Information Technology;

- Pre-operating expenses;

- Expenditures with the trading of new products and services;

- Expenditures with personnel training;

- Reformation of large equipment and installations, which aim at modernizing or increasing the productive capacity;

- Investments in urban and social infrastructure; and

- Working capital associated to the fixed investment.

- Book Publishing Sector (items 58115/00 and 58212/00 of National Classification of Economic Activities [CNAE] 2.0 Fiscal of the Brazilian Institute of Geography and Statistics [IBGE], except for the publishing of abridgements)

- Publishing plans of, at least, Five (5) works of technical and cultural content, with a minimum printing, per work, of three thousand (3,000) issues: investments in the acquisition of copyrights (except for foreign authors), translation, technical revision, preparation of trial versions and final review of books and other special versions in other vehicles (works in

Braille, audio books, CD-ROM, etc.), involving the production and commercialization of editions for the domestic and export markets.

Non-financeable Items

- Acquisition of land and other real estate properties;
- Costs and expenses with current maintenance;
- Transfer of assets, except in special cases of productive activities reactivation projects;
- Acquisition of foreign-manufactured software, except when associated to projects for technological development and innovation or adaptation (customization/tropicalization) carried out in Brazil;
- Actions and social projects contemplated with fiscal incentives;
- Any expenditures that imply in value remittance, including franchise tax paid in the exterior;
- Acquisition of new machines and equipment, considered the industrial and systems sets, produced in the country, not accredited in BNDES;
- Items isolated that do not constitute an investment project;
- Acquisition of animals for resale;
- Any investments or expenses of any nature, including the concession of the BNDES Card, in the sectors:
    - Real-state endeavors, such as residential buildings, time-sharing, hotel-residence and lots;
    - Gun trade in the country;
    - Financial/ banking activities, except in the case of Microcredit;
    - Motels, sauna and thermal pools;
    - Endeavors in the mining sector that incorporate the process of rudimentary mine working or panning; and
    - Endeavors related to gambling and similar activities.
- The support to import of the following items will not be eligible:
    - Movable equipment destined to transportation of any nature, including load moving, construction, paving and farming transportations, including chassis and waggons;
    - Banking automation equipment;

- Working capital associated to installation of imported equipment; and
- Equipment and machines already introduced in the country.

NOTE: Real estate acquisition may, at BNDES' discretion, be considered a financeable item, provided that it is directed to a social project the community.

Additional International Resources:

Export Import Bank of the United States (Ex-Im Bank)

The Export-Import Bank of the United States (Ex-Im Bank) is the official export credit agency of the United States. Ex-Im Bank's mission is to assist in financing the export of U.S. goods and services to international markets.

Ex-Im Bank does not compete with private sector lenders but provides export financing products that fill gaps in trade financing. We assume credit and country risks that the private sector is unable or unwilling to accept.

Ex-Im Bank provides working capital guarantees (pre-export financing); export credit insurance; and loan guarantees and direct loans (buyer financing).

With more than 70 years of experience, Ex-Im Bank has supported more than $400 billion of U.S. exports, primarily to developing markets worldwide.

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Website: www.exim.gov

Federation of International Trade Associations

The Federation of International Trade Associations (FITA), founded in 1984, fosters international trade by strengthening the role of local, regional, and national associations throughout the United States, Mexico and Canada that have an international mission.

FITA affiliates are 450+ independent international associations which fall into six categories.

The 400,000 organizations linked to FITA through their membership in a FITA member association represent a broad cross-section of the international trade community: manufacturers, trading companies, contractors, freight forwarders, custom house brokers, airlines, shipping companies, port authorities, banks, insurance brokers and underwriters, associations and a wide range of service providers including telecommunications companies, law firms, and consultants.

Organization Contact Information:
The Federation of International Trade Associations
172 Fifth Avenue, Suite 118 • Brooklyn, NY 11217
Phone: (718) 871-0369
Email: info@fita.org – General Inquiries
kpark@fita.org – Member Information
Website: http://www.fita.org/

Inter-American Investment Corporation

The Inter-American Investment Corporation is a multilateral financial institution that is part of the Inter-American Development Bank Group. The IIC is mandated to promote the economic development of its regional developing member countries located in Latin America and the Caribbean by encouraging the establishment, expansion, and modernization of private enterprises in such a way as to complement the activities of IDB.

To fulfill its mandate, the IIC offers a range of products and services such as -short-term loans, up to two years (working capital or trade finance), medium-term loans, up to five years (working capital, corporate loans, or project finance), long-term loans, up to fifteen years (corporate loans or project finance), syndicated A and B loans, equity and quasi-equity investments, and credit guarantees for loans and debt instruments.

All II C's clients are private enterprises–preferably, although not exclusively, small and medium-size companies. The IIC offers in Colombia, Mexico, and Peru and under specific conditions, financing denominated in local currency. Among the beneficiaries are financial intermediaries, including leasing companies.

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Website: http://www.iic.int

International Trade Administration

The Office of Finance seeks to enhance the domestic and international competitiveness of key U.S. financial services industries in order to increase their exports and investment overseas. Primary areas of focus for the Office of Finance include insurance, securities, banking, venture capital, private equity, pensions and asset management, exchanges, mortgage, leasing, and non-bank financing. Our office supports these programs and activities through our Financial Services and Trade and Project Finance teams.

Organization Contact Information:
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U.S. Department of Commerce
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Email: scott.schmith@mail.doc.gov
Website: http://www.ita.doc.gov/td/finance/

Inter-American Development Bank

The Inter-American Development Bank (IDB), the oldest and largest regional bank in the world, is the main source of multilateral financing for economic, social and institutional development in Latin America and the Caribbean. Its loans and grants help finance development projects and support strategies to reduce poverty, expand growth, increase trade and investment, promote regional integration, and foster private sector development and modernization of the State.

The IDB Group is composed of the IDB, the Inter-American Investment Corporation (IIC) and the Multilateral Investment Fund (MIF). The IIC focuses on support for small and medium-sized businesses, while the MIF promotes private sector growth through grants and investments.

In recent years the Bank has launched a number of initiatives aimed at applying new approaches to reduce poverty, promote small businesses, stimulate trade and extend financial democracy.

Organization Contact Information:
1300 New York Avenue, NW • Washington, DC 20577
Phone: (202) 623-1000
Fax: (202) 623-3096
Website: http://www.iadb.org/

International Finance Corporation

IFC fosters sustainable economic growth in developing countries by financing private sector investment, mobilizing capital in the international financial markets, and providing advisory services to businesses and governments.

IFC helps companies and financial institutions in emerging markets create jobs, generate tax revenues, improve corporate governance and environmental performance, and contribute to their local communities. The goal is to improve lives, especially for the people who most need the benefits of growth.

IFC offers an array of financial products and services to its clients and continues to develop new financial tools that enable companies to manage risk and broaden their access to foreign and domestic capital markets.

Organization Contact Information:
International Finance Corporation
2121 Pennsylvania Avenue, NW • Washington, DC 20433 USA
Phone: (202) 473-1000
Website: http://www.ifc.org/

Multilateral Investment Guarantee Agency

Since its inception in 1988, Multilateral Investment Guarantee Agency (MIGA) has issued nearly 900 guarantees worth more than $17.4 billion for projects in 96 developing countries. MIGA specializes in facilitating investments in high-risk, low-income countries–such as in Africa and conflict-affected areas. By partnering with the World Bank and others, MIGA is able to leverage finance for guarantee trust funds in these difficult or frontier markets. The agency also focuses on supporting complex infrastructure projects and promoting investments between developing countries.

MIGA's technical assistance services also play an integral role in catalyzing foreign direct investment by helping developing countries define and implement strategies to promote investment. MIGA develops and deploys tools and technologies to support the spread of information on investment opportunities. Thousands of users take advantage of our suite of online investment information services, which complement country-based capacity-building work.

The agency uses its legal services to further smooth possible impediments to investment. Through its dispute mediation program, MIGA helps governments and investors resolve their differences, and ultimately improve the country's investment climate.

Organization Contact Information:
Multilateral Investment Guarantee Agency
World Bank Group
1818 H Street, NW • Washington, DC 20433 USA
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Website: http://www.miga.org/

Overseas Private Investment Corporation (OPIC)

OPIC is a U.S. government agency that sells political risk insurance and loans to help U.S. businesses of all sizes invest and compete in more than 150 emerging markets and developing nations worldwide.

OPIC's mission is to:
-Foster economic development in new and emerging markets;
-Support U.S. foreign policy; and,
-Create U.S. jobs by helping U.S. businesses to invest overseas.

OPIC charges market-based fees for its products and therefore it operates on a self-sustaining basis at no net cost to taxpayers. OPIC places a special emphasis on supporting U.S. small businesses in their efforts to expand into emerging markets overseas. OPIC established a Small Business Center and Small and Medium Enterprise Finance Department to coordinate OPIC expertise for the development of small business deals through a streamlined approval process aimed at reducing costs for U.S. small businesses.

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EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye On The Future

Future Focused Research for the Equipment Finance Industry

Presented by the Source for Independent, Unbiased and Reliable Study

The Equipment Leasing & Finance Foundation

The Equipment Leasing & Finance Foundation, established in 1989 by the Equipment Leasing Association, is dedicated to providing future-oriented, in-depth, independent research about and for the equipment finance industry. Information involving the markets, the future of the industry and the methods of successful organizations are researched to provide studies that include invaluable information for developing strategic direction within your organization.

Your Eye on the Future

The Foundation partners with corporate and individual sponsors, academic institutions and industry experts to develop comprehensive empirical research that brings the future into focus for industry members. The Foundation provides academic research, case studies and analyses for industry leaders, analysts and others interested in the equipment finance industry.

The Foundation's resources are available electronically or in hard copy, at no cost to Foundation donors and for a fee to non-donors. The Foundation website is updated weekly. For more information, please visit www.leasefoundation.org

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- Propensity to Finance Equipment – Characteristics of the Finance Decision
- Business Differentiation: What makes Select Leasing Companies Outperform Their Peers?
- Annual State of the Industry Report
- Evolution of the Paperless Transaction and its Impact on the Equipment Finance Industry
- Indicators for Success Study
- Credit Risk: Contract Characteristics for Success Study
- Study on Leasing Decisions of Small Firms

Resources: Identification of Emerging Issues

- Annual Industry Future Council Report
- Identifying Factors For Success In the China
- Renewable Energy Trends and the Impact on the Equipment Finance Market
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