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CAPITAL MARKETS DEVELOPMENT FUND (FUMCAP)

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(Unofficial Translation)

I - Evaluation

A. Technical Assistance Program (PAT)

The FUMCAP-Technical Assistance Program (PAT), which was created as a parallel activity to the underwriting operations, became an important initiative resulting in great benefits to the 4,546 technicians involved. The purpose of PAT was to develop training courses to upgrade personnel engaged in the capital market area through the realistic outlook of the national financial system in general and the capital market in particular.

The programming carried out during the four and half years of PAT covered many topics from less sophisticated courses such as "Introduction to Capital Market" to more complex subjects demanding a larger experience from the participants. Among the latter, it is worthy mentioning the Auditing Courses for the training of accountants aimed at qualifying them for accreditation with the Central Bank.

The auditing courses were initially developed by the Brazilian Institute of Capital Markets (IBMEC) under a contract with the Brazilian Institute of Independent Auditors (IAIB), and later, given by IAIB and the University of São Paulo (USP), in long-term courses going deeper into the subject matter. In addition to a broad outlook of the national financial system, credit markets and capital and exchange markets, and the relating legislation, specific auditing topics were covered, such as: Audit Evaluation in Brazil, The Professional field of the Auditor, Reports and Opinions, Accounting Technical Procedures, Accounting Controls, Accounting Results, Central Bank Functions, Auditing with Computers, etc. On this latter topic it is worthy mentioning that USP - in addition to the course on

"Independent Auditing Specialization" - administered a course on "Auditing of Electronic Data Processing Systems" and others on "Statistical Sampling Applied to Auditing", "Consolidation of Financial Statements" and "Financial Reports and Inflation". The last two courses for Accountants, Economists and Administrators.

The emphasis placed on this type of activity was due to the reasons already mentioned and also to meet the requirements under the USAID Agreement which called for, among others, the training of accountants, specially in the area of auditing.

(4) The "Financial Executive Training Program" carried out by the Getúlio Vargas Foundation (FGV), also long-term, had the purpose of providing a basis of financial and economic analysis for executives in the public and private sectors, with special emphasis on investment analysis for technicians responsible for decision making in the areas of finance and capital market. Six courses of this type were conducted for a total of 3,417 hours with the participation of 366 technicians.

(5) The activities carried out by the Institute of Brazilian Lawyers (IAB) were mostly short-term seminars and symposium covering several subjects with a heavy emphasis on the legal aspects of capital market. Thus, subjects taught to participants were "Sociedade Anonima" (corporation law), Debenture, Disclosure, Protection to Minority Shareholders, Investment in Foreign Securities, Foreign Capital Participation in National Companies, New Corporate Law and the Security Commission (CVM).

IBMEC was the institution which conducted the largest number of training courses, with a broad variety of activities, covering specific topics such as: "Open Market", "Underwriting", "Controller of Security Brokers Office", "Shareholder Department Management", "Marketing", as well as more relevant topics such as: "The Brazilian System of Re-evaluation and Monetary Correction", "Capital Market Regulation", "Financial Institution Administrator", "Capital Market for Institutional Investment" and "Capital Market Legislation and the New Corporate Law". In addition to this, international meetings were held in Rio de Janeiro such as: "Latin American Seminar on Monetary Policy and Public Debt Administration", "Capital Market Regulation Symposium", and "International Seminar on Capital Market and Economic Development".

The IAIB carried out its activities in the auditing area only and USP conducted courses in the areas of auditing and accounting, except the course on "Capital Market Specialization" (694 hours) with the purpose of preparing qualified personnel for high level functions in companies engaged in the capital market (financial institutions and corporations with stock negotiated in the Stock Exchange).

The type and duration of activities varied from institution to institution even though each institution retained some of its own characteristics. Thus, the courses conducted by IBMEC, un general, lasted from 2 to 3 months (80 to 100 hours). The courses conducted by FGV and IAIB lasted around 380 hours while IAB conducted short-term seminars (varying from 6 to 30 hours) and USP administered 2 long-term courses and the remaining courses from 1 to 2 months duration (45 to 60 hours).

Therefore, besides the broad variety of subjects covered, the activities sponsored by PAT presented different structures in order to meet all types of clientele - supplying both broad and specific training courses and the review and debate of current relevant subjects.

As to the relative cost of the courses, it is not easy to make comparisons due to differences among activities as well as the lack of previous experience to be used as a basis. From the data submitted, we calculated two financial indices which we thought might give a comparative view about the performance of each entity. These indices were "Cost per Participant" (CPP) - final activity cost divided by the number of participants - and "Cost per Hour" (CPH) - final cost divided by the number of instruction hours in the course. We noticed that the Cost per Participant was higher in long-term activities, since they are more expensive and also on account of the limited number of participants enrolled. This was the case of FGV (CPP = Cr\$10.458,15) and IAB (CPP = Cr\$5.983,14). This was also the case of USP (CPP = Cr\$8.743,99) due to its two long-term courses which pushed the index upwards.

The Cost per Hour should be a better indicator because it relates only the two main variables directly. Thus, we have noticed that IAIB was the institution which operated with the lowest costs (CPH = Cr\$692,43) and IAB with the highest costs (CPH = Cr\$2.919,86), followed by USP (CPH = Cr\$1.747,51).

IBMEC was the institution which spent the largest amount of money (Cr\$7.646.647,00) with the execution of 46 hours in a total of 5,200 instruction hours with the participation of 1,809 students. IBMEC was the institution which participated more actively among the five institutions under the PAT program.

In terms of cost, the FGV appeared in second place with total expenditures in the amount of Cr\$4.319.214,00 in the execution of 7 courses totalizing 3,705 instruction hours, followed by IAIB (Cr\$3.081.317,00), USP (Cr\$2.238.462,00) and IAB (Cr\$1.073.047,00). In terms of participants IAB appeared in the second place (1,554 students, after IBMEC, followed by

IAIB (515 students), FGV (413 students) and USP (256 students). As to the total instruction hours the distribution was as follows:

IBMEC	5,200 hours
IAIB	4,450 hours
FGV	3,705 hours
USP	1,296 hours
IAB	368 hours
Total	15,019 hours

* The important aspect to be pointed out is that, without PAT support, these institutions would not have been financially able to develop and execute the number of courses which were conducted, at a reasonable cost for the participants. To illustrate this we choose as an extreme example the course on "Financial Institution Administrator" conducted by IBMEC at a total of Cr\$1.248.809,61 for the activities carried out in Brazil only (619 hours). The group was composed of 17 students, on a full-time basis, with the right to receive a maintenance allowance fee. The Cost per Participant was Cr\$84.619,00 which lead us to conclude that without PAT support this course probably would not have been conducted.

In every course, evaluation questionnaires were filled in by the students for the purpose of measuring the efficiency of each activity. Based on this evaluation we believe that the courses conducted under the PAT program actually contributed to the professional upgrading of participants. This success was due mainly to the fine performance of the implementing institutions all traditionally engaged in teaching activities - and also to the quality of the professors who were hired for teaching the courses.

Difficulties encountered by PAT, specially in the beginning of program activities, were mostly related to formal requirements of program implementation rather than related to PAT qualitative aspects. Thus, it took some time before the Central Bank and the training institutions were able to adequately systematize all essential services to achieve PAT objectives in accordance with the standards established by USAID under the Loan Agreement. Once the procedures for processing USAID release of funds were defined, transfer of funds and refunds to institutions, preparation and analysis of rendering of accounts and other necessary tasks, PAT program began to function at a normal pace.

Program guidelines for each entity were established by the Central Bank and USAID and after becoming operational they were smoothly followed by the institutions as planned for. Some courses covering topics which were always arousing interest were repeated, whereas courses covering new topics were introduced whenever necessary, either by the demand from interested parties or by the need to meet the market interest - for example, the courses on

"New Corporate Law" and "Security Commission" (CVM).

All told, PAT/FUMCAP carried out 100 activities, 92 were carried out in Brazil and 8 were carried out abroad. The training activities carried out in the United States in the period 1975 through 1977 resulted in an extremely useful experience. This training provided an opportunity for several Brazilian technicians to have a direct contact with American specialists, to exchange information in their professional fields and to make a close observation of a sophisticated market in operation, the techniques used and the control and inspection mechanisms.

We quote below a portion of the report written by Mr. Nicholas Rey, Vice-President of Merrill Lynch, a New York based Brokers' Office, which summarizes his observations on FUMCAP when he visited us in 1974:

"Based on the analysis I made in Brazil on FUMCAP objectives, operations and future prospects, my opinion is that the USAID Loan funds allocated to the Underwriting Program is less important to the development of the Brazilian Capital Market than the funds allocated to the Technical Assistance Program. This happens to be so, because Brazil possesses the necessary internal resources to finance FUMCAP underwriting operations. Besides, I believe that, to increase the use of "firm offer" underwriting, provide financing to underwriters, is not so important as to change the process of price determination.

What Brazil needs more is the development of technical specialization in the Capital Market, not only for the high level executives and brokers, but mainly for accountants, lawyers and specially government officials in the regulation area.

My review of the Technical Assistance activities developed to date led me to conclude that the Program covered many of the essential areas and produced the expected results involving a large variety of technicians engaged in the Capital Market.

The courses offered until the present time, both by IBMEC and IAB, although I have not examined them in detail, seem to be of the finest quality. Many of them should be repeated on a continuing basis for many years, particularly the training courses for independent auditors and legislation for lawyers."

A total of 92 activities were sponsored by PAT in Brazil - providing training for 4,547 technicians in 15,015 hours of instruction for a total cost of Cr\$18.358.689,00. Total proceeds collected from enrollment fees amounted to Cr\$4.402.329,93 deposited in a revolving fund for the purpose of supporting program continuity after contract completion.

In addition to the instructional activities carried out in Brazil by 5 institutions, PAT also sponsored a study on Capital Market carried out by specialists recommended by IFC, Mr. Hans Horch from Mercator Organization and Mr. Frank Veneroso. Payment to Mr. Horch was made in local currency in the amount of Cr\$240.000,00. Therefore, total cruzeiros spent in Brazil was Cr\$18.598.689,00 (Cr\$18.358.689,00 + Cr\$240.000,00), corresponding to US\$1,767,338.99.

Costs of activities carried out abroad were recorded based on information received from USAID and amounted to US\$527,967.10, including the payment made to Mr. Frank Veneroso for US\$23,900.00.

Therefore, the total cost for PAT, both dollar and cruzeiro currencies, amounted to US\$2,295,306.09 (US\$1,767,338.99 + US\$527,967.10). The amount of US\$204,693.91 has not been used and represents 8% of US\$2,500,000.00 allocated to PAT. This unused balance of US\$204,693.91 has been deobligated by USAID through Implementation Letter Nº 14, dated October 12, 1977.

B. Underwriting Operations

There is no doubt that the main discouraging factor for the issuance of new stocks was due to contingencies of secondary market which, during the period, presented as a predominant characteristic the lack of resources, concentrated in blue chip stocks, especially those of state companies. The poor performance of the secondary market, which would guarantee liquidity for existing and new stocks, discouraged the application of financial resources in new stock issuance, causing this type of financing to slow down considerably. That attitude on the part of the financing agents was due to the inconvenience of assuming the risk of issuances that would delay in being absorbed by the market. The evidence is the predominance of issuances of the best-effort type.

Another factor that we consider of great weight is the availability of funds managed by BNDE which operational system calls for a much less complex bureaucratic structure and more attractive costs, placing BNDE now as a mere company creditor (financing), and then as a participant of its capital (purchase of stocks), instead of a mere intermediary agent (FUMCAP), thus receiving preference from investment Banks.

FUMCAP costs became excessive in relation to other sources of money, considering that there was no limit for monetary correction. Interest was not high, 8% p.a. for the issuance of debentures - considered to be market interest - and for the issuance of stocks 6% p.a. in the first year, 7.75% in the second year and 12% in the third year.

As to the liquidity system, due to structural reasons of the secondary market, the liquidity system planned for FUMCAP did not work in either of the underwriting issues. We believe that, in the maner the system

was structured, it could have had the conditions and resources to effectively provide liquidity to FUMCAP stocks. However, the small number of stocks - financed as well as the long recession experienced by our secondary market. led the system not to achieve the purposes originally established.

In addition to the natural difficulties stemming from the lack of previous experience with operations under the Fund, unfamiliarity - both on the part of the investing public and the companies themselves - towards the operational and legal characteristics of convertible and not convertible debentures - stock which should be mainly unused in FUMCAP operations - was also responsible for the modest reaction from undertakers.

It is understandable, however, that the prevailing climate of world economy had some negative reflexes over the financial and capital markets, resulting in some judiciousness on the part of investors and corporations.

Total funds used in underwriting operations amounted to Cr\$27.916.486,10 (Cr\$17.251.827,27 from BNDE and Cr\$10.664.658,83 from USAID and IFC), as mentioned above in paragraph 71. Foreign resources from USAID and IFC amounted to US\$1,537,599.16.