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Brazil releases regulations for issuance of infrastructure debentures

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On Wednesday, March 27, 2024, Brazil's federal government published Decree 11.964, with regulations on the criteria and conditions for classifying and monitoring the priority investment projects in infrastructure or in intensive economic production in research, development, and innovation that will qualify for funding through "Incentive Debentures", "Infrastructure Debentures", and certain other securities that carry special tax benefits.

The Decree defines **(i)** "Incentive Debentures" as those provided for in article 2 of Law 12.431/11; **(ii)** "Infrastructure Debentures" as those provided for in Law No. 14.801/24; and **(iii)** "securities with tax benefits" collectively as Incentive Debentures, Infrastructure Debentures, real estate receivable certificates (CRI), and shares in receivables investment funds (FIDC) issued under article 2 of Law 12.431/11. Foreign-issued debt securities (bonds) were not specifically addressed in the Decree, although they benefit from some of the new rules.

While the Decree fills in significant gaps related to the issuance of these securities, some conditions will be established later, by directives issued by sector ministries and by the Ministry of Finance.

Project Eligibility

The core of the regulations is the definition of the "priority" projects that will be eligible for funding through Incentive and Infrastructure Debentures. The focus is on the public interest and sustainability, and important sectors such as oil and mining in general are left out.

As a rule, priority projects are those which (i) are carried out under government concession, license, authorization, lease or, in the case of projects related to basic sanitation, under a program contract;[1] (ii) involve new construction or expansion, recuperation, adaption or modernization; and (iii) belong to one of the following sectors:

1. **Logistics and transportation:** Projects related to highways, railways (including engines and cars), waterways, organized ports and port facilities (including terminals for public use, cargo transshipment stations and tourism port facilities), airfields and airport support facilities, excluding private airfields;
2. **Urban mobility:** Projects related to urban public transportation infrastructure, acquisition of collective vehicles for use in public transportation infrastructure, such as trains, ferries, automated people movers and cable cars, acquisition of electric buses, including those powered by fuel cells, and of biofuel or biogas hybrid buses. Projects for acquisition of buses that emit polluting gases are not included;

3. **Energy:** Projects for power generation from renewable sources, transmission and distribution of electricity, natural gas, production of biofuels and biogas, except in the agricultural phase, production of low carbon intensity synthetic fuels, low-carbon hydrogen, capture, storage, handling, and use of carbon dioxide, and pipelines for fuel transport, including biofuels and low carbon intensity synthetic fuels.
4. **Telecommunications and broadcasting**;
5. **Basic sanitation**;
6. **Irrigation**;
7. **Free public education**;
8. **Free public health**;
9. **Public safety and the prison system**;
10. **Public urban parks and conversation units**;
11. **Public equipment for culture and sports**;
12. **Social housing:** Only projects carried out through public-private partnerships are eligible;
13. **Urban renewal**;
14. **Processing of strategic minerals for the energy transition:** Expenses incurred in mine development and mining may be considered part of investment projects, on conditions to be specified in a directive issued by the relevant ministry; and
15. **Public lighting**.

As for projects for intensive economic production in research, development and innovation, the eligible sectors are energy transition, ecological transition, digital transformation, medical and healthcare manufacturing, and the aerospace and defence industries, on terms to be specified in a directive issued jointly by the Ministry of Finance and the relevant sector ministry.

In comparison with the priority sectors established by the earlier regulations under Decree 8874/16, the exclusion of the oil and mining sectors caught the market's attention. In addition some sectors that were included under Decree 8874/16 are also listed in the new Decree, but with new requirements. The education and health sectors, for example, were already identified as priorities, but now the projects must focus on free, public education and health to be eligible.
Another important change under Decree 11.964 is that the expense of obtaining the concession or other grant for infrastructure projects cannot be included as part of the investment project. In the words of article 5§2 of the Decree, "the issuance of securities with tax benefits is limited to an amount equal to the **capital expenses** of investment projects."
On the other hand, a number of new sectors are included by the new Decree, such as public lighting and the processing of minerals that are strategic to the energy transition.

Infrastructure Bonds and the International Market

Although the new Decree does not devote particular attention to bonds issued by Brazilian companies in the international market, it does not restrict the applicability to bonds from the benefit under Law 14.801/24. The income tax exemption (zero-rate income tax) will therefore apply to interest paid on bonds issued to fund investment projects in priority infrastructure areas – which will be based on the same parameters applicable to Infrastructure and Incentive Debentures.

One significant change related to bonds is that the Ministry of Finance may now authorize acquisition of Infrastructure Debentures by a related legal entity domiciled outside Brazil, "provided the acquisition is made in connection with the issuance and placement of bonds related to the Infrastructure Debentures outside Brazil." This provision opens up the possibility of "matched" issuances of securities, where an offshore subsidiary of a Brazilian company issues bonds in the international market and uses the funds obtained to acquire debentures in Brazil by its parent company, thus facilitating the entry of funds into Brazil and benefiting from the tax benefit applicable to interest paid on the debentures.

Another provision of interest to the international market is that the Decree allows Infrastructure Debentures to be issued with an exchange rate variation clause, which can be attractive for issuers that have part of their operations and/or revenue in foreign currency. The exchange rate variation clause can even be tied into a bonds issue, under a possibly matched bond-debenture issuance structure, which may influence issuers' decision to raise funds via bonds or debentures. It is worth noting that the Decree does not expressly extend the possibility of exchange rate variation clauses to Incentive Debentures under Law 12.431/11.

Tax Benefits Not Cumulative

Although Decree 11.964 expressly states that the tax benefits under Law 12.431/11 and under Law 14.801/24 cannot apply simultaneously to the same debenture, it does seem possible to have two series, one with each benefit, in the same debenture issuance. In fact, article 21 expressly provides that debentures may be issued with the two benefits for the same project, as long as the sum of the funds raised does not exceed the investment project's capital expenses.

This would allow the sponsor of a project to target different sectors of the investing public, using the benefits applicable to Incentive Debentures in one series, to attract investors in general (including individuals), and the benefits of Infrastructure Debentures in another series, to attract institutional investors such as pension funds, for example.

The Coming into Effect of the new Decree and Incentive

Debentures issued under the previous regulations

The new Decree revokes and replaces Decree 8874/16, which established the rules applicable to Incentive Debentures. Directives issued by sector ministries under the old Decree will remain in force to the extent they do not conflict with the new regulations.

For projects that were approved under the old regulations but do not meet the requirements under the new Decree, Incentive Debentures can be issued within 90 days from 27 March 2024, and will continue to enjoy tax benefits. However, project owners that issue Incentive Debentures in the 90-day transition period will be required to submit the information needed for project monitoring and inspection under the new regulations.

Inspection and Monitoring

On the subject of inspection and monitoring of projects funded by Infrastructure and Incentive Debentures or other securities with tax benefits, the Decree provides that the Issuer must:

1. file detailed information on the investment project with the sector Ministry, prior to submitting the application to register the securities offering;
2. ensure that the sector Ministry has up-to-date information on **(a)** the legal entities forming part of the Issuer and the project owner; and **(b)** the controlling company of the Issuer or the project owners, if the Issuer or the project owner is a listed company;
3. ensure that the offering documents state, clearly and in language accessible to investors, in accordance with Brazilian securities and exchange commission – CVM regulations, **(a)** a description of the project, **(b)** the Issuer's commitment to allocate the funds obtained to the priority project, and **(c)** the number and date of publication of the ministry directive approving the project, if required;
4. ensure that the funds are used to carry out the priority project, and maintain the documentation related to the use of the funds available for consultation and inspection for at least five years after maturity of the securities with tax benefits or the winding-up of the receivables fund.

When applying to the CVM for registration of the offering, the Issuer must present proof that the information referred to in item 1 above has been filed. An interesting innovation under the new regulations is that the Decree speed-tracks review by the CVM and sector Ministries of projects that have significant social or environmental benefits.
According to the Decree, the implementation of projects will be overseen by the relevant sector Ministries and the Ministry of Finance's Economic Reform Secretariat, while a special department of the Federal Revenue of Brazil will be responsible for monitoring and assessing the tax benefits.

Sector Ministry Directives

Although the Decree sets out the general eligibility criteria and conditions for priority projects, and confirms that prior approval by the relevant ministry is not required, it does leave some matters to be established by directives issued by the ministries:

1. priority sub-sectors and additional eligibility criteria and conditions, where relevant;
2. simplified procedures for prior ministerial approval for projects that involve public services owned by states, the federal district or municipalities, where applicable; and
3. procedures for monitoring implementation of priority projects, directly by the ministry or through regulatory agencies or other entities.

With the sector sub-regulations delegated to the ministries, there are still some open questions on the exact criteria that will be used for each sector, and it is unclear how the issuance of these securities will function until the sector sub-regulations are released.
In any event, issuers and project owners are responsible for ensuring that their projects meet the eligibility criteria under the Decree, that the funds raised are used in accordance with legal requirements, and the projects are carried out in compliance with the regulations.

Conclusion

Now that the new regulations been issued, the expectation is that Brazil's infrastructure sectors will see increased investment. The new Infrastructure Debentures, along with infrastructure bonds with tax benefits, join the well-established Incentive Debentures, and have the potential to open up investors' purses to an infrastructure market that is hungry for investment – especially pension funds and international investors. Some questions still have to be answered – such as whether infrastructure investment funds (FI-Infra), which also enjoy tax benefits, will be able to invest in Infrastructure Debentures in addition to Incentive Debentures, and the extent to which Infrastructure Debentures will compete with project bonds, after taking into account all market factors, such as the interest rate curve and the cost of issuing securities for placement outside Brazil.

In the short term, despite the uncertainty over future ministerial directives and some questions as to the interpretation of the new regulations and the stance that the various government authorities involved in priority projects may take, Decree 11.964 is expected to boost Brazil's fixed income market.

NOTE

[1] This criterion does not apply to projects for processing of strategic minerals for

the energy transition, or to actions in infrastructure projects designed to reduce or mitigate greenhouse gas emissions.

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