



DIRECT ISSUES OF DPMFI SECURITIES

Direct issues of Domestic Federal Public Securities Debt - DPMFi are defined as those targeted to specific objectives, as defined in law. They are characterized by direct placements of public securities without auctions or other types of public offers.

Currently, examples of the direct issues include: securitization of debts; payment of Export Financing Program (PROEX) interest rate equalization; guarantees of financial resources deposited in judicial accounts (FUNAD); financing for higher education students and guarantee of reception of Social Security debts from Higher Education Institutions (FIES); and issues for purposes of agrarian reform (TDA), among others.

I. Debt Securitization

The National Treasury is responsible for renegotiation of debts contracted as a result of legislation, or administrative or contractual acts of entities whose liabilities were or may come to be legally assumed by the federal government.

Aside from these cases, current legislation authorizes the National Treasury to renegotiate debts of the federal government or to be honored by the federal government as a result of guarantees granted to organs or entities over which it has direct or indirect control.

Almost all of these debts originate in contracts formalized but not honored in which the principal creditors are the public and private banking systems, suppliers, service provider companies and companies contracted to execute government projects.

The operational procedures related to renegotiation of these liabilities involve the recontracting of the conditions specified in the original contracts. Rights and characteristics that are almost always heterogeneous and belong to a variety of creditors are exchanged for homogeneous credit instruments. This process is known as debt securitization.

In summary, securitization can be defined as debt renegotiation, utilizing new contracts as the underlying mechanism. For creditors, the process has the main advantage of recovering the liquidity of their assets. From the point of view of the government, securitization makes it possible not only to adjust National Treasury financing requirements to that institution's payment capacity, but also contributes importantly to regaining public sector credit.

In this context, an important step was taken when the National Treasury decided to register securitized debts in the system developed by the Custody and Settlement Clearinghouse - CETIP. Among other advantages, this decision resulted in enhanced transparency for the different types of public debt, increased institutional control over federal public indebtedness and strengthening of the reliability and agility of secondary market operations.

The securitization process demands compliance with a series of steps starting with examination of the documentation corresponding to the liabilities in question. The certainty, liquidity and the ability to call these liabilities must be verified beforehand. Once these requirements have been met, negotiations begin among the interested parties, with the objective of defining the details of the instrument to be issued as a result of securitization.

Various debt securitization contracts were signed and can be divided into two large groups according to their origin. The first group encompasses contracts formalized by government companies and other entities that were extinguished by law. The second group includes assets originating in the securitization of debts for which the federal government is directly responsible or that must be paid by the federal government as the guarantor of the operation.

Therefore, among others, the following securitized credits were issued by the federal government in the early 1990s:

- SIBR910701 – former Siderbrás debts with the Vale do Rio Doce Co.;
- NUCL910801 – former Nuclebrás debts with the banking system;
- PORT911016 – former Portobrás debts with BNDES;
- SOTV910901 - federal government debts referring to expropriation of a river port in Belém do Pará.

Consequently, payments of debts with foreign creditors are processed through direct issues of public securities registered in a book-entry custody system. These assets have specifically defined characteristics and use possibilities and are freely negotiated on the secondary market. Normally, they can be used to acquire properties and rights that are transferred within the framework of the National Privatization Program - PND.

Currently, with the exception of Wage Variation Compensation Fund – FCVS debts, which have a specific legally defined type of security, debt securitization is carried out through issue of just one type of public security, in keeping with the National Treasury's objective of reducing the number of securities in circulation and achieving greater liquidity for its bonds. For this purpose, the security used is the National Treasury Note - Series B – NTN-B.

Legislation: Decree no. 1,647, 9/16/1995 and Decree no. 1,785, 1/11/1996

I.1 Wage Variation Compensation Fund – FCVS

Dated December 21, 2000, Law no. 10,150 authorized renewing Wage Variation Compensation Fund – FCVS debts by the federal government. The financing institution holding net credits against the FCVS, involving debt balances remaining at the termination of housing mortgage contracts covered by the Fund and formalized with final borrowers of the Housing Finance System - SFH, receives assets (CVS) registered in the Custody and Settlement Clearinghouse - CETIP, as payment.

Legislation: Law no. 10,150, dated 12/21/2000 and Decree no. 4,378, dated 9/16/2002.

I.2 Privatization Currencies

In the 1990s, the use of the term "privatization currency" as a synonym for "securitized debt securities" became common. However, privatization currencies represented all federal government liabilities, including securitized debt bonds, that could be used by the participants in privatization auctions as a way of paying for auctioned shares.

When a specific company was included in the privatization process, the National Privatization Council - CND defined the maximum percentage that would be accepted in privatization currencies for each proposal submitted for that company. The difference would then have to be covered in legal tender.

Aside from the securitized debt papers, other federal government and state-owned company papers were also included among privatization currencies, including Agrarian Debt Bonds - TDA, created for the purpose of allowing the federal government to effect payments of indemnities generated by land expropriations of social interest, to be used for agrarian reform purposes; Treasury Financial Certificates - CFT - which were created to be used preferentially in operations with objectives specifically defined in legislation; National Development Fund Obligations - OFND, Siderbrás Debentures with National Treasury guarantees, Mortgage Bills - LH, and Brazilian external debt restructuring bonds.

When privatizations resulted in payments in legal tender, the resources were used for purposes of amortization of the federal public securities debt and for the current expenditures of programs in the areas of science and technology, health, national defense, public safety and the environment, according to terms approved by the President of the Republic.

II. Renegotiation with States and Municipalities

II.1 Renegotiation with States and the Federal District

Law no. 9,496, dated September 11, 1997, authorized the federal government to assume and refinance state and Federal District debts, with the objective of fostering a public sector fiscal adjustment at the state level. The following types of debts were included among those assumed:

1. Public Securities Debt (public securities) constituted up to March 31, 1996 and debts constituted after that date when they correspond to the rollover of previous debts.

2. Contractual Debts:

- Other liabilities consequent upon internal and external credit operations of any contractual nature, involving net and certain investment outlays callable by December 31, 1994;
- Loans taken by the states and Federal District in operations with the Federal Savings Bank, based on the terms of Federal Senate Resolution no. 70, dated December 5, 1995;
- Credits held by the federal government against states.

For purposes of debt assumptions formalized on the basis of Law no. 9,496/97, after being authorized by the Federal Senate, specific refinancing contracts were formalized with the various states and debt assumption contracts were signed with each one of the creditors. These contracts establish the conditions for issues of public securities (Treasury Financing Bills – Series A and B – LFT-A and LFT-B and securitized debt papers) to be used in paying off debts with the cited creditors.

For the most part, the state and Federal District debts were refinanced for periods of 30 years, with interest of 6% per year or 7.5% per year plus monetary updating according to the General Price Index (IGP-DI), announced by the Getúlio Vargas Foundation - FGV, with monthly payments according to the price table

system (constant installments, also known as the French amortization system), limited to a specific percentage of real net revenues - RLR.

Legislation: Law no. 9,496, dated 9/11/1997, and Declaratory Statute no. 101, dated 5/4/2000

II.2 Program for Reducing the Presence of the State Public Sector in Banking Activities (PROES)

Aside from debt assumption operations based on Law no. 9,496/97, Provisional Measure no. 1,514-1, dated August 7, 1996, authorized the federal government to open additional credits to the states and Federal District, through issues of public securities (National Treasury Bills – Series A and B – LFT-A and LFT-B, and securitized debt papers), with the objective of furthering the Program for Reducing the Presence of the State Public Sector in Banking Activities, in order to generate resources for:

- Extinction of state financial institutions through processes of incorporation, merger, split-ups or any other type of legally permitted stock holding reorganizations;
- Creation of state development agencies regulated by the National Monetary Council. These development agencies would be entitled to provide guarantees, utilize chattel mortgages as guarantees and industrial and commercial credit bills, while also levying charges as done by financial institutions.

The resources made available through the mechanism established by this Provisional Measure were financed by the federal government and incorporated into the respective debt balances of the states and Federal District, according to the terms of the contracts formalized on the basis of Law no. 9,496/97, with the same conditions described in the paragraphs above.

Declaratory Statute no. 101, dated May 4, 2000, prohibited formalization of new contracts among the states. However, the Provisional Measure underlying

these operations was reissued several times as a consequence of other provisions. Its most recent reissue is referred to by number 2,192-70 dated 8/24/2001.

Legislation: Provisional Measure no. 2,192-70, dated 8/24/2001, and Declaratory Statute no. 101, 5/4/2000.

II.3 Renegotiation with Municipalities

Provisional Measure no. 1,811-1, dated February 25, 1999, authorized the federal government to assume and refinance the following liabilities of the municipalities, with the same objectives as described above for the states and Federal District. This was to be done through issues of public securities (Treasury Financing Bills, Series B – LFT-B):

- Debts with national or foreign financial institutions, based on contracts signed up to January 31, 1999, including debts generated by transformation of anticipated budget revenue operations into long-term debt;
- Debts with national or foreign financial institutions, generated by credit assigns formalized by January 31, 1999;
- Internal security debts constituted by December 12, 1995, or that were constituted after that date as rollover of previous security debts;
- External security debts constituted by December 12, 1995, or that were constituted after that date as rollover of previous security debts;
- Debts involving anticipated budget revenue operations contracted up to January 31, 1999; and
- Debts referring to credit operations formalized with financial institutions as financial agents of the federal government, states or regularly constituted government funds and programs.

For the most part, municipal debts were refinanced for up to 30 years, with charges of 6% per year or 9% per year plus monetary updating based on the General (wholesale) Price Index (IGP-DI), announced by the Getúlio Vargas

Foundation - FGV, with monthly payments according to the price table system (constant installments, also known as the French amortization system), limited to a specific percentage of real net revenues - RLR.

Declaratory Statute no. 101, dated May 4, 2000, prohibited formalization of new contracts among the states. However, the Provisional Measure underlying these operations was reissued several times as a consequence of other provisions. Its most recent reissue is referred to by number 2,185-35 dated 8/24/2001.

Legislation: Provisional Measure no. 2,185-35, dated 8/24/2001, and Declaratory Statute no. 101, 5/4/2000.

III. Special Programs

Based on Decree no. 3,859 and Law no. 10,179, dated 7.4.2001 and 2.6.2001, respectively, the National Treasury issues securities for the purpose of furthering a variety of government programs.

III.1 Export Financing Program – PROEX

This measure is designed to compensate states that grant credits to exporters, in the PROEX framework, with financial charges compatible with those in effect on the international market. It is a system of interest rate equalization, based on issues of National Treasury Notes – I Series– NTN-I.

Legislation: Law no. 10,184, 2/12/2001; Resolution no. 3,219 (BACEN) 4, 6/30/2004; Directive no. 374 (MDIC), 12/21/1999; and Directive no. 58 (MDIC), dated 4/10/2002.

III.2 Higher Education Student Financing Fund – FIES

The purpose of this Fund is to provide financing to students enrolled in paid higher education courses. This is done through issue of specific Treasury Financing Certificates – Series E – CFT-E for FIES, as determined in the paragraph of article 22 of Decree no. 3,859, 7/4/2001. These papers are issued to

educational institutions that then grant tuition reductions to students. The papers must be used preferentially to pay the debts of these institutions with the INSS, which then redeems these debts from the National Treasury, thus improving its financial situation.

Legislation: Law no. 10,260, 7.12.2001.

III.3 National Anti-Drug Fund - FUNAD

This Fund has the objective of generating resources for preventing and combating drug use. The resources originate in specific issues of Treasury Financing Certificates – Series B – CFT-B, as determined in the paragraph of article 19 of Decree no. 3,859, dated 7/4/2001. Amounts in cash seized from suspected drug traffickers are maintained in judicial deposits until the criminal proceedings against the individual are concluded.

In order to further efforts against drug trafficking, the resources are anticipated to FUNAD and the National Treasury then substitutes them with CFT-B issues that are maintained by the judiciary.

Once the case has been resolved by the courts, the National Antidrug Secretariat - SENAD, which is subordinated to the presidency of the Republic, requests that the National Treasury cancel or redeem the securities in question, depending on whether the federal government has been successful in convicting the suspect.

Legislation: Law no. 10,409, dated 1/11/2002 and Law no. 9,804, dated 6.30.1999.

III.4 National Privatization Program - PND

Resources received by foundations, semi-autonomous agencies, public companies, joint capital companies and any other entities directly or indirectly controlled by the federal government, as a consequence of sale of minority stockholdings were transferred to the National Treasury in exchange for National

Treasury Notes - Series P – NTN-P. These resources were used for purposes of amortization of the federal public securities debt.

Legislation: Decree no. 1,068, 3/2/1994; Decree no. 2,594, 5.15.1998; and Law no. 9,491, 9/9/1997.

III.5 Agrarian Reform

Agrarian Debt Bonds – TDA - were created for purposes of payment of indemnities to persons whose lands were expropriated or who formalized Purchase and Sale Agreements with the federal government, involving rural properties to be used for purposes of agrarian reform.

Legislation: Federal Constitution, art. 184; Law no. 8,177, dated 03/01/1991; Land Law - Law no. 4,504, dated 11/30/1964; Decree no. 578, 06/24/1992; Decree no. 433, dated 01/24/1992; and MP no. 2,183-56, dated 08/24/2001.

III.6 Farm Debt

According to the terms of Law no. 9,138, dated 11.29.1995, the National Treasury assumed the debts of rural producers contracted with financial institutions or cooperatives up to 6/20/1995. In their place, the Treasury issued securities (ASTN) with the same earnings as the original debts. Consequently, borrowers then paid their debts to the National Treasury through financial institutions. These payments were updated according to product prices plus 3% interest per year. The difference in the rates and indexing factors generated the volume of resources to be equalized.

Legislation: Law no. 9,138, dated 11/29/1995

III.7 Special Asset Restructuring Program - PESA

Part of the debts covered by Law no. 9,138, dated 11/29/1995, can be renegotiated under special conditions determined by the National Treasury. In order to do this, the debtors must acquire National Treasury Certificates - CTN, with

face value equal to the value of the debt to be renegotiated. Such papers were then delivered to the creditor as a guarantee of principal.

Starting in September 2003, the National Treasury is no longer authorized to carry out these operations since the period allowed was not extended by the National Monetary Council – CMN.

Legislation: Law no. 9,138, dated 11/29/1995; CMN Resolution no. 2,471, dated 02/26/1998; CMN Resolution no. 3,078, dated 04/24/2003; MF Directive no. 58, 3/27/1998; and MF Directive no. 183, 7/31/2003.

III.8 Audiovisual Program

Legislation authorized exchanges of renegotiated external debt securities issued as a result of the Brady Plan and Interest Due and Unpaid Bonds - IDU for National Treasury Notes – Series D, to be invested exclusively in projects involving production, distribution, exhibition and publicity in Brazil and abroad related to Brazilian audiovisual works; preservation of the memory and documentation of this activity; and donations to the National Culture Fund – FNC.

Legislation: Law no. 8,313, dated 12/23/1991; MF Directive no. 202, dated 08/19/1996.