

THE ASSOCIATION OF GLOBAL CUSTODIANS

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& TRUST COMPANY
THE NORTHERN TRUST COMPANY
STATE STREET BANK AND TRUST COMPANY

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August 8, 2002

VIA AIR COURIER

Mr. Amauri Bier
Executive Secretary of the Finance Ministry
Ministério da Fazenda
Esplanada dos Ministérios - Bloco P - 4o. andar
Gabinete do Secretário Executivo
70048-900 Brasília, Distrito Federal - Brasil

Mr. Francisco de Assis Guimarães de Paula
Secretaria da Receita Federal
Av. Presidente Antônio Carlos, 375 - 9º andar - sala 914
CEP 20020-010 - Rio de Janeiro RJ - Brasil

Re: CPMF Tax Exemption

Gentlemen:

I am writing on behalf of the Association of Global Custodians ("Association"), an informal group of nine U.S. banks that are major providers of global custody services to institutional investors. The members of the Association hold, through local banks acting as subcustodians, very substantial positions in the securities of Brazilian companies for their institutional investor clients. Accordingly, the Association has a strong interest in the administration and interpretation of the recently-adopted Constitutional Amendment concerning the Contribuição Provisória sobre Movimentações Financeiras or CPMF tax. For the reasons set forth in this letter, the Association urges that the disparate CPMF treatment of pre- and post-July 13, 2002 investment, and the resulting requirement, announced by the Receita Federal, on July 12, that financial institutions maintain two accounts for each investor, be repealed.

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Background

Constitutional Amendment 37 exempts from the CPMF foreign exchange transactions related to trading in stock, in options on stock, and in derivatives on stock indices, which take place on stock exchanges or in the organized over the counter market. We understand that the objective of Constitutional Amendment 37 is to stimulate investment and trading in the Brazilian capital markets and to remove one of the incentives to offshore trading in the shares of Brazilian companies. The amendment, which was enacted on June 13, 2002, became effective 30 days later.

On Friday, July 12, 2002, the last business day before the effective date of the new exemption, Receita Federal issued Normative Instruction 173. This pronouncement sets forth procedures that financial institutions must adopt under the new exemption. Among other things, Instruction 173 requires financial institutions to establish two cash accounts for each investor -- one account for cash transfers related to exempt transactions and another for cash transfers related to non-exempt transactions. Similarly, in order to identify securities that, when sold, will generate proceeds that are CPMF exempt, it is also necessary to maintain two securities accounts for each investor. This dual account structure is the result of Receita Federal's view that foreign exchange outflows from sales of assets that were acquired prior to July 13 are not exempt and must therefore be segregated from assets acquired after July 13.

Discussion

The Association believes that Constitutional Amendment 37 is a very positive step to encourage investment in the Brazilian markets. We are concerned, however, that Receita Federal's implementation of the Amendment may unintentionally frustrate the goals of the Amendment and impose unnecessary costs and burdens on financial intermediaries. We urge that the difference in tax treatment of outflows related to pre- and post- July 13 investment be re-considered.¹

¹ If, as we are requesting, Receita Federal's interpretation that the tax applies to these assets is withdrawn, a reclaim procedure should be established so that taxes already paid can be recovered. We understand that, at present, there is no reclaim mechanism in Brazil that would cover this situation.

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Maintaining two separate cash and securities custody accounts for each investor -- as is necessary under Receita Federal's interpretation -- is a very burdensome undertaking. Dual account maintenance is inconsistent with existing financial institution automated recordkeeping procedures. The need to either manually track investment transactions, based on the original purchase date of the security involved, or to devise a way to re-program existing computerized systems to meet this requirement, would be extremely costly and time-consuming. The added complexity of dual accounts will also increase the likelihood of errors and fails, with the attendant expense of investigating and correcting such problems. Inevitably, these added costs and interruptions in routine processing of Brazilian market transactions will affect the institutional investors that are the clients of the members of the Association. The result will be to make Brazil a more expensive and less attractive market for foreign capital. Conversely, offshore trading in Brazilian equities, such as through ADR programs, will become more, rather than less, appealing in comparison to local market trading.

We also believe that it is important to consider the adverse impact on the reputation of the Brazilian capital markets that is likely to result from the manner in which Constitutional Amendment 37 is being implemented. Foreign investors that follow the Brazilian markets had no advance notice that pre- and post-July 13 investments would be taxed differently and therefore had no opportunity to factor that possibility into their investment decisions. Indeed, Receita Federal's regulations were only announced on the business day prior to the day on which the Amendment became effective. Abrupt and unexpected actions of this nature, with no opportunity for prior public comment or reaction, do not promote investor confidence in the stability and predictability of regulatory policy. They are a deterrent to foreign capital, especially in the current turbulent and uncertain market environment.

Conclusion

For the reasons stated above, the Association urges that the disparate CPMF treatment of pre- and post-July 13 investment, and the correlative dual account structure requirement, be repealed. We believe that such action would aid in making

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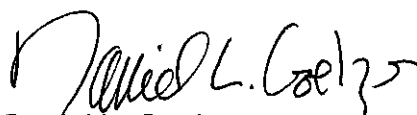
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the Brazilian market more attractive to foreign investment and would accordingly be consistent with the objectives of Constitutional Amendment 37.²

The Association has reviewed the July 24 letter concerning this matter to Mr. Bier from the Associação Nacional dos Bancos de Investimento e Desenvolvimento and the July 17 letter to Luiz Fernando Cardoso Maciel, Banking Operations Department, Banco Central do Brasil, from JPMorgan Chase Bank (a member of the Association) which makes some of the same points. The views expressed in those letters are similar to the Association's, and we support the recommendations therein.

The Association very much appreciates your consideration of these issues. If you wish to discuss this matter, or have any questions concerning these comments, please contact either the undersigned at 202/452-7013 or Don G. Linford, Vice President, Head of Network Management Western Hemisphere, JPMorgan Investor Services at 718/242 1545. Mr. Linford is fluent in Portuguese.

Sincerely,



Daniel L. Goelzer
Counsel to the Association

cc: Mr. Luiz Fernando Figueiredo
Monetary Policy Director
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² In the event that the distinction between assets acquired before and after July 13 is not abolished, there are several unresolved interpretive issues that will need to be promptly addressed. For example, there are inconsistent views among market participants concerning the application of the CPMF to dividend payments related to pre-July 13 positions and to the treatment of cash balances that were on deposit before July 13, 2002.

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