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Investors Silverado Ask for Compensation

Translated from DCI, published on September 15, 2016

Translated by LASFA from DCI, a Brazilian business newspaper, published on September 15, 2016. Author unknown.

This is the first of a series of articles that LASFA will be publishing to highlight the problem of fraud and larceny in Brazil's securities markets, especially the market for Asset-backed Securities (ABS).

Investors in the credit fund Silverado (translator's note – actually a Brazilian Asset-backed Security structured as a fund and named Fundo de Investimento em Direitos Creditórios or FIDC), led by BTG Pactual, JP Morgan and Sul América Investments, are asking about R$400 million in compensation for the losses from alleged fraud due to the fund's (mis)management. The battle is being fought in the courts not only against Silverado Management and Investments, which managed the fund, but also against the banks BNY Mellon, Deutsche Bank, Santander and Gradual (a brokerage), which provided services to the credit fund (FIDC – BNY Mellon was the Administrator and Deutsche Bank was the Custodian of Maximum, Gradual and Santander for Maximum II).

Translator's Note: This is the first time in the fifteen-year history of the FIDC market that we have seen investors take the service providers (the administrators and custodians) to court because of fraud in a FIDC.

The accusation against the manager is that it allegedly used front companies to "warm up" the invoices (in other words, the companies were created to implement a fraudulent strategy, but first the front companies submitted invoices for financing and the front buyers paid them when due to stay below the radar of the analysis designed to detect fraud). The first manipulation allegedly happened in a small percentage of the fund, to avoid recording defaults, which could have scared off investors. But over time, the manager allegedly began to use more and more cold notes (bad paper – the front companies began sell more fraudulent notes that they did not plan to pay). According to the argument of the investors, in the end, about 90% of the portfolio contained claims that will not be recovered because they are from fictitious transactions.

A credit fund is almost like a bank (Translator’s Note: a Brazilian investment fund can also buy credit –Fundos de Crédito Privado[Private Credit Funds] but these were Fundos de Investimento em Direitos Creditórios [FIDCs] – an ABS set up like a fund to buy private debt - the Silverado funds in question were FIDCs - they are under different regulations), but restricted to one type of operation: discounting the legal equivalent of trade invoices. (Translator’s note: This is an error from DCI, FIDCs can buy any kind of credit instrument from factoring to corporate bonds to car loans). In this type of business (factoring), a particular company that sells products or provides some service anticipates receipt of money through this operation. The fund buys the invoices (from the seller of the merchandise or service) to be paid by the companies (to the FIDC not the original seller) that purchased the services or bought products.

In the case of Silverado, the manager allegedly advanced funds to shell companies, which belonged to Silverado the controller (Translator Notes: manager and owner of the subordinated shares), and that supposedly provided services to large Brazilian companies. But one expert hired by the investors apparently has proven that the notes are cold. Investors, however, declined to comment.

The management (Silverado, the FIDC manager) claims that there was no fraud, but declined to be interviewed to explain their arguments. He only said in a statement sent by his press office, which "is ready to cooperate with the Justice and sees the actions an opportunity to clarify the real causes of the loss by appropriate funding."

History

Silverado was founded by a veteran of the financial markets, Manoel Teixeira de Carvalho Neto. He came to be in charge around R$750 million (US$234 million) allocated in (several) credit funds (FIDCs - ABS). Among the investors were not only customers as BTG Pactual, JP Morgan and Sul América Investments, but also wealthy (weighty) entrepreneurs who, through their family office, invested in the funds.

These investors say they are damaged, not only because of fraudulent management but also because the fund service providers gave their seal of insurance that the investment was free of fraud. This will be the case against the custodians of the Silverado funds, Deutsche and Santander, which should verify the legitimacy of all loans. In addition, the administrators, Gradual and BNY Mellon, should have supervised the FIDCs. None of those involved wanted to comment.

Evidence of fraud was found in two Silverado funds (FIDCs) called Maximum and Maximum II, who had until the beginning of the year a net worth of around R$470 million. The alert for investors came when the risk rating agency S&P decided in February to withdraw their credit ratings on the FIDCs. Investors then gathered in assembly and deposed the manager. In June, they decided to seek compensation in court. Silverado was also the owner of the funds (Translator Note: since Silverado owned the subordinate shares) as well as the manager. In June, the investors decided to seek compensation in court. Silverado was also the owner of other funds (FIDCs), one that had invoices owed by Petrobras, delivered by the company's

(Petrobras') suppliers, but this fund had no problem. The information is from the newspaper O Estado de S. Paulo.

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