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Brazil

LENDING & SECURED FINANCE

Contributing firm

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This country-specific Q&A provides an overview of lending & secured finance laws and regulations applicable in Brazil.

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BRAZIL
LENDING & SECURED FINANCE

1. Do foreign lenders require a licence/regulatory approval to lend into your jurisdiction or take the benefit of security over assets located in your jurisdiction?

No.

2. Are there any laws or regulations limiting the amount of interest that can be charged by lenders?

There is a certain controversy on the actual limit applying to either interest rate or default rate in Brazil. However, in the opinion of most Brazilian scholars and precedent cases interest rates are limited to 12% a year and default rates shall not be 1% higher than the applicable interest rate. As ruled by Brazilian courts, such limitations do not apply to either (i) transactions that are carried out by institutions that are part of the Brazilian financial system (such as banks, leasing companies, etc.) or on the Brazilian capital market, or (ii) cross-border loans registered with the Central Bank of Brazil.

3. Are there any laws or regulations relating to the disbursement of foreign currency loan proceeds into, or the repayment of principal, interest or fees in foreign currency from, your jurisdiction?

In the event of a cross-border loan, all transfers of funds from abroad to Brazilian companies must be made through a bank and be registered with the Electronic Declaratory Registration, available at the Central Bank's Electronic Information System ("SISBACEN") through the Financial Operations Registration Module ("ROF"). Such registration must be made by the Brazilian borrower prior to the inflow of any loan amounts into Brazil. It is essential that a ROF number be obtained in connection with a cross-border loan transaction, since this is a requirement for the purpose of closing currency exchange contracts in connection with the inflow of loan funds into Brazil and thereafter the transfer of amounts in foreign currency to lender abroad for payment of the principal, interest and any other charges relating to such loan.

Central Bank of Brazil allows that the registration of a cross-border loan be completed provided that its payment terms, including applicable interest rate, are consistent with those prevailing on the international market.

4. Can security be taken over the following types of asset: i. real property (land), plant and machinery; ii. equipment; iii. inventory; iv. receivables; and v. shares in companies incorporated in your jurisdiction.

All assets mentioned above when situated in Brazil may be subject to a security interest under Brazilian law.

In order to enable the creation of a lien on a property or asset situated in Brazil, the relevant security document must be governed by Brazilian law.

Except for a mortgage deed that must be executed by the parties before a Notary Public in Brazil, other security documents can be entered into by means of private instruments signed by the parties. In all events the security documents must be registered, as explained in question 8 below.

5. Can a company that is incorporated in your jurisdiction grant security over its future assets or for future obligations?

Under Brazilian law, each property, asset or right given as a security must be fully identified at the time the lien is perfected, thus it is not possible to create a lien on future assets, real property, accounts, and inventory that

cannot be identified.

As a requirement for the effectiveness of any security document (whether mortgage, pledge, or fiduciary sale in guarantee), such document must contain a description of: (i) the total debt or an estimate thereof; (ii) the repayment term; (iii) the interest rate (if applicable); and (iv) the description of the secured property or asset, along with elements necessary to its identification.

6. Can a single security agreement be used to take security over all of a company's assets or are separate agreements required in relation to each type of asset?

In principle, this is possible, provided that the identification requirement mentioned in 5 above in connection with each asset is satisfied. In addition, if the assets include a real property to be mortgaged, then the relevant mortgage deed must be entered into by means of a public deed signed by the parties before a Notary Public in Brazil.

7. Are there any notarisation or legalisation requirements in your jurisdiction? If so, what is the process for execution?

As mentioned above, if the assets include a real property to be mortgaged, then the relevant mortgage deed must be entered into by means of a public deed signed by the parties before a Notary Public in Brazil. For other types of assets, the security documents can be entered into by means of a private instrument, signed by the parties. Notarization of signatures is required in the event of documents to be registered in a Real Estate Registry.

If any security document is entered into by means of a private instrument signed abroad, such document must be notarized by a local Notary Public and thereafter apostilled by the competent authorities. Moreover, if any security document is drafted in a language other than Portuguese,

it must be translated by a certified translator in Brazil and registered with a Registry of Titles and Documents.

8. Are there any security registration requirements in your jurisdiction?

A security document must be registered (i) in case of real property or a pledge of inventory, in the competent Real Estate Registry in the city where such property or the asset is located, or (ii) in the event of movable assets, including receivables, with a Registry of Titles and Documents in the Municipality in Brazil where the borrower is domiciled.

In addition, in the event of shares, the relevant security document must be further registered in the appropriate corporate books or, in the event of a limited liability company, stated in its Articles of Association

The security document must be further registered with (i) the State Departments of Transportation, in the event of vehicles, (ii) Brazilian Aeronautical Registry, in the event of aircraft, (iii) the Brazilian Maritime Registry, in the event of shipping, and (iv) Brazilian National Institute of Industrial Property, in the event of intellectual property.

Finally, as a requirement for the effectiveness of a pledge over receivables against the relevant debtors of such receivables, the debtors must be notified of the institution of the pledge and provided with instructions for the payments to be made to pledgee, rather than to pledgor.

9. Are there any material costs that lenders should be aware of when structuring deals (for example, stamp duty on security, notarial fees, registration costs or any other charges or duties), either at the outset or upon enforcement?

The perfection of a security document in Brazil requires the payment of basically notarization, sworn translation into Portuguese, if applicable, and registration fees. Notarization fees are negligible. Sworn translations are charged based on the number of pages translated and registration fees on the underlining transaction total principal amount to be secured by the security document. Usually, lenders require the fulfillment of the formalities needed to be accomplished for the perfection of the security interest as a condition either precedent for the disbursement of the funds or post-closing, failure of which may cause an acceleration of the debt maturity.

10. Can a company guarantee or secure the obligations of another group company; are there limitations in this regard?

There is no legal provision in Brazilian laws prohibiting a Brazilian company from guaranteeing or securing obligations of a parent company, subsidiary, or other members of its corporate group. However, please refer to our additional comments to the question below

relating to financial assistance.

11. Are there any issues that lenders should be aware of when requesting guarantees (for example, financial assistance or lack of corporate benefit)?

As per a general rule of Brazilian corporate laws, a company shall only perform activities and acts that are compatible with its corporate purposes. In this sense, the grant of a guarantee or a security by a Brazilian company to a loan to be used only for the benefit of its shareholders or affiliates could in theory be judged as an act incompatible with its corporate purpose. Notwithstanding such possibility, the grant of a guarantee or a security by a Brazilian company to secure its parent company's obligations is not unusual and to the best of our knowledge there are no precedent cases specifically ruling such acts as fraudulent.

12. Are there any restrictions against providing security to support borrowings incurred for the purposes of acquiring shares: (i) of the company; (ii) of any company which directly/indirectly owns shares in the company; or (iii) in a related company?

Same comments as in the preceding question 11 above.

13. Can lenders in a syndicate appoint a trustee or agent to (i) hold security on the syndicate's behalf, (ii) enforce the syndicate's rights under the loan documentation and (iii) apply any enforcement proceeds to the claims of all lenders in the syndicate?

Under Brazilian laws, security interests are to be instituted in favor of the creditor of the underlining obligations to be secured by such security interests. Therefore, as a general rule, a security agent may sign a security document governed by Brazilian laws on behalf of a creditor basically as per the following alternatives:

(i) As creditor's attorney-in-fact.

In this event, the relevant security interest to be created will be registered in Brazil in creditor's name to secure the debtor's obligations owed to such creditor, as represented by the security agent appointed to act as creditor's attorney-in-fact.

(ii) As creditor's fiduciary agent.

In this event, the security agent will be appointed by the creditor to act as the fiduciary holder of both the credit rights arising out of the debtor's obligations and the relevant security interest created to secure such obligations. Under this alternative, the security agent will be treated for all purposes of Brazilian laws as the registered holder of the credit rights against the debtor and the beneficiary of the relevant security interest. Therefore, only the security agent (rather than the creditor) will be in a position to enforce the security in Brazilian courts. In order to enable the creditor to directly enforce the security in Brazil, it will be necessary that it previously obtains either (i) an assignment from the security agent, or (ii) a judicial or arbitral order recognizing it as a security agent's successor in relation to the security and as long as such order is issued abroad, it must be ratified by the Brazilian Superior Courts.

In the event of an insolvency proceeding, Brazilian case law permits bondholders to choose to be represented by their indenture trustees or to individualize their right to vote on the credits involved.

14. If your jurisdiction does not recognise the role of an agent or trustee, are there any other ways to achieve the same effect and avoid individual lenders having to enforce their security separately?

Please refer to our comments in the preceding question.

15. Does withholding tax arise on (i) payments of interest to domestic or foreign lenders, or (ii) the proceeds of enforcing security or claiming under a guarantee?

(i) In the event of a foreign loan, to the extent that it is registered with the Central Bank of Brazil, the repatriation of its principal amount abroad will be tax free. Brazilian borrower will be required to pay withholding income tax on any interest or other fees paid to lender abroad.

Inflow/outflow of funds into/from Brazil can only be implemented through foreign currency exchange agreements to be entered by the Brazilian resident with a local financial institution. Such agreements trigger a tax called IOF/Forex.

(ii) Under Brazilian tax laws currently in effect, capital

gains obtained by an individual or legal entity resident or domiciled abroad, as a result of the sale of assets and rights situated in Brazil, including equity interest held in Brazilian companies, are subject to a 15% (or 25%, in case of sellers located in tax havens) withholding income tax.

16. If payments of interest to foreign lenders are generally subject to withholding tax, what is the standard rate and what is the minimum rate possible under double taxation treaties?

Pursuant to tax laws and regulations currently in effect, withholding income tax standard rate is 15% or 25% if lender is resident of a tax haven. IOF/Forex rates may vary from 0% to 6% depending on the nature of the transaction and the average payment term.

Usually, a double taxation treaty grants the right that the tax paid in one of the countries that is party to this treaty may be set off against the tax paid or to be paid in the other country, also by a party to the treaty, so as to avoid that an income becomes subject to double taxation simultaneously in both countries that are parties thereto.

The Double Tax Treaty between Brazil and Japan reduces the general withholding tax rate to 12.5% and grants exemption to governmental entities. Double Tax Treaties between Brazil and certain other countries, such as Spain, Canada, France, and Netherlands, potentially reduce the withholding tax rate to 10% and grants exemption to governmental entities, provided that certain minimum tenure or other requirements be met.

17. Are there any other tax issues that foreign lenders should be aware of when lending into your jurisdiction?

Income of foreign lenders will not become taxable in Brazil solely because of a loan to or a guarantee or security from a Brazilian company but please refer to withholding income tax due on payment of interest, capital gains and IOF/Forex, as mentioned in 15 above.

In addition, it is customary that gross-up provisions be set forth in cross-border loan agreements.

Finally, as a general rule, a Brazilian borrower is entitled to deduct interest paid under a foreign or a domestic loan in the determination of its taxable income. However, some restrictions on the deductibility of interest may apply under thin capitalization rules in the event of loans granted to Brazilian borrowers by (i) foreign related shareholders or companies, or (ii) lenders resident in tax havens and privileged fiscal regimes. In case of loans from foreign related shareholders or companies, a debt-to-equity ratio of 2:1 will apply. In the event of loans from lenders resident in tax havens and privileged fiscal regimes, the applicable debt-to-equity ratio will be 3:1.

18. Are there any tax incentives available for foreign lenders lending into your jurisdiction?

Tax exemptions may apply to certain transactions in Brazil, such as those involving certificate of real estate receivables, long-term infrastructure debentures and investments made in investment funds to finance infrastructure projects.

19. Is there a history in your jurisdiction of financing structures being challenged by tax authorities, and if so, can you give examples.

There is no significant precedent case to be mentioned.

20. Do the courts in your jurisdiction generally give effect to the choice of other laws (in particular, English law) to govern the terms of any agreement entered into by a company incorporated in your jurisdiction?

Although a party's choice of law is not excluded by Brazilian conflict of law rules, its application may be limited in certain cases where Brazil is considered to be the place of contracting or performance of the obligations deriving from the related agreements. In addition, a provision of a foreign law shall not be upheld as valid when it is considered to be in violation of a public policy, morality or sovereignty of Brazil or a fraud under Brazilian law.

21. Do the courts in your jurisdiction generally enforce the judgments of courts in other jurisdictions and is your country a member of The Convention on the Recognition and Enforcement of Foreign Arbitral Awards?

The courts of Brazil usually recognize as valid and

enforce final judgments issued by foreign courts, provided that such judgments do not offend Brazilian public order and sovereignty and good morals, and provided further that an "exequatur", which can be defined as an enforcement order, is issued by the Brazilian Superior Court of Justice.

Brazil is a party to the New York Convention ratified on 23 July 2002 (Decree No. 4,311), among others, such as the Panama Convention, ratified on 9 May 1996 (Decree No. 1,902), the OAS Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards (the Montevideo Convention) and the OAS Inter-American Convention on International Commercial Arbitration of 1975.

22. What (briefly) is the insolvency process in your jurisdiction?

(1) Judicial restructuring. A debtor-in-possession court supervised reorganization proceeding, inspired by Chapter 11 of the US Bankruptcy Code, in which the debtor submits a restructuring plan for creditors' approval and court confirmation. If a restructuring proceeding is filed, the debtor shall enjoy a 180-day stay that may be extended for an equal period, during which required majorities of creditors must approve a reorganization. If a plan is not approved, the company will be liquidated. It is worth mentioning that as a result of a recent reform of Law No. 11,101/05 in late 2020, creditors have been granted the right to impose a reorganization plan on the debtor, prepared exclusively by them, whenever the debtor's plan is not offered in a timely manner or when it is rejected at the creditors' meeting.

The debtor maintains management of an insolvent entity. (2) Extrajudicial restructuring. A proceeding where the debtor is able to obtain an agreement with a class or group of creditors before filing a restructuring. A debtor may propose an extrajudicial restructuring to one or more classes of creditors, or groups of creditors which share similar economic interests. If more than 50% of the credits belonging to that class or group approve the plan, it becomes binding on all creditors in such a class or group upon court confirmation.

All claims subject to a judicial restructuring may also be subject to extrajudicial restructuring, provided that for labor credits an agreement with the relevant Union is required. (3) Bankruptcy, or liquidation. Upon declaration of bankruptcy, the debtor loses control of the activity and is replaced by a judicial administrator. The assets of the bankrupt estate are collected, appraised, and subsequently sold, preferably as a going concern, in order to pay creditors in accordance with priority rules provided by law. Labor claims have the highest priority, but only up to the limit of 150 minimum wages per claim. Secured claims, up to the value of the security, rank second, above tax claims. Unsecured and subordinated credits come last in the list of priorities.

These three alternative procedures are available to any business entity, with the exception of financial institutions, insurance companies, cooperatives, and government owned entities

23. What impact does the insolvency process have on the ability of a lender to enforce its rights as a secured party over the security?

Creditors that hold title or ownership rights as security to assets are, in principle, not affected by an insolvency filing and are therefore authorized to enforce their rights.

Courts have however been resistant to applying this rule, in its strictest sense, whenever the enforcement of such rights during the stay period can jeopardize the reorganization of the insolvent company. Several theories have emerged to justify this position, amongst which are the "essentiality" of the asset, the lack of "individualisation" of the credit, the recognition that the acceleration clause of such a debt is subject to the filing or even the partial enforcement of the rule.

These matters are still being discussed at all levels in the state courts and a final definition has yet to be established.

24. Please comment on transactions voidable upon insolvency.

The claw back period is up to 90 days before an insolvency is recognized. However, a fraudulent conveyance may be declared whenever an asset transfer leaves the debtor without the means to pay its debts at the time of the transfer, provided that the transfer reduces the creditor's ability to recover its credits. In addition, if there is an enforcement lawsuit pending, a creditor has the right to attach the transferred assets directly, if the debtor is left without assets to pay the debt which is already being enforced (fraud against enforcement).

25. Is set off recognised on insolvency?

Yes, as a general rule.

26. Can you comment generally on the success of foreign creditors in enforcing their security and successfully recovering their outstandings on insolvency?

From a legal perspective, and in general terms, foreign creditors have been successful in exercising their rights to recover their credits under an insolvency scenario.

27. Are there any impending reforms in your jurisdiction which will make lending into your jurisdiction easier or harder for foreign lenders?

No.

28. What proportion of the lending provided to companies consists of traditional bank debt versus alternative credit providers (including credit funds) and/or capital markets, and do you see any trends emerging in your jurisdiction?

Main financing providers are currently traditional banks. However, it is expected that in the post-crisis Covid-19 pandemic recovery, transactions involving private credit (that is, extension of loans by nonbank actors) and issuance of bonds on capital markets can significantly increase.

29. Please comment on external factors causing changes to the drafting of secured lending documentation and the structuring of such deals such as (i) Brexit (ii) LIBOR transition and/or (iii) COVID 19

There is no significant factor to be mentioned in respect of specific changes to the drafting of secured lending documentation and the structuring of such deals.

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