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SHORTER ARTICLES, COMMENTS AND NOTES

Foreign Loans in Brazil: Theory and Practice

Loans made by foreign entities in Brazil are strictly regulated and subject to constantly changing legislation and administrative rulings and guidelines. Consequently, it is difficult for practicing lawyers who are called upon to advise foreign lenders or Brazilian borrowers on proposed credit operations to stay abreast of recent developments in this area. Even if counsel is familiar with the most recent legislative and administrative changes, he or she may find it difficult to determine in what manner the various legal provisions—frequently badly drafted and inconsistent with existing regulations—will be applied by the Brazilian governmental authorities. Indeed, many times it takes considerable effort just to confirm which governmental agencies are responsible for enforcing the new policies and provisions governing foreign loans. The purpose of this article is to call attention to some recent changes in the rules of the game, to point out some inconsistencies between what is written and what is practiced, and to describe in summary fashion the principal governmental requirements presently in effect regarding foreign loans in Brazil.

Decree No. 84,128

The most recent major legislation governing credit operations in Brazil is Decree No. 84,128, which was promulgated on October 29, 1979. (A translation of the Decree appears in Appendix A.) Decree No. 84,128 applies only to foreign loans made to the following: so-called state enterprises, e.g., public and mixed-capital companies and their subsidiaries; all entities controlled directly or indirectly by the federal government; governmental agencies and foundations; and autonomous governmental organs. The Decree does not just cover credit operations; rather, it aims to establish control by the federal government of all resources and expenditures of state enterprises. It serves as a good example of the general nature and tendency of recent legislation and of the difficulties associated with the interpretation of any such legislation.

In the area of foreign credit operations, Decree No. 84,128 creates a new governmental agency (Secretariat of Control of State Enterprises, or SEST), abolishes an agency of the Brazilian Central Bank (Foreign Loan Commission, or CEMPEX) and stipulates a number of new governmental authorizations and approvals which must be obtained by Brazilian state enterprises

prior to contracting for foreign loans. Decree No. 84,128 requires the following:

- a. authorization from the Secretariat of Planning of the Presidency of Brazil (SEPLAN) to enter into negotiations relating to the terms of the loan;
- b. opinion of SEST recognizing the degree of priority of the specific project or program being financed by the loan and the ability of the borrower to repay the loan; and
- c. in the case of import finance loans, evidence that the loan falls within the borrowing limits approved by the President of Brazil for certain foreign trade transactions.

The provisions above created some ambiguities, though. For example, although Decree No. 84,128 expressly maintains the preexisting requirement that the Central Bank authorize negotiations relating to the terms of corresponding loan agreements, it simultaneously abolished the agency of the Central Bank that hitherto had issued such authorization under Decree No. 65,071 of August 27, 1969. Also, the Decree does not mention Article 4 of Decree-Law 1,312 of February 15, 1974, as amended. That Decree-Law requires the Minister-Chief of SEPLAN to issue a statement about the ability of the borrower to repay the loan and about the national development priority to be given to the project for which the money is being borrowed. Thus, it is unclear whether both SEPLAN and SEST must issue a statement regarding the priority of the project or program being financed. In this context, it should be remembered that SEST was created by Decree No. 84,128 as a central organ within the basic structure of SEPLAN.

So far, in credit operations involving state enterprises, SEPLAN has issued only one statement. That statement incorporates: (1) the authorization of SEPLAN referred to in "a" above; (2) the opinion of SEST referred to in "b" above; and (3) the statement of the Minister-Chief of SEPLAN provided for in Article 4 of Decree-Law 1,312, as amended. What happens in practice is that SEST sends an internal document to the Minister-Chief of SEPLAN, who subsequently issues the statement referred to above.

Experience in import financing loans has shown that all evidence allegedly confirming that a particular loan falls within the borrowing limits approved by the President of Brazil is considered confidential, and therefore not available to interested third parties (i.e. the lenders). Counsel to the lenders must, therefore, rely on a representation by the borrower or its counsel that the particular loan falls within the corresponding borrowing limits, and should qualify his legal opinion accordingly.

Central Bank Resolution No. 595

For some time, Resolution 432 required that all foreign currency loans entering Brazil be deposited with the Central Bank for a stipulated time period. Central Bank Resolution No. 595 of January 16, 1980, the latest in a series of compulsory deposit regulations, now provides that, with the excep-

tion of loans to the public sector, foreign currency loans entering Brazil after January 16, 1980 shall have one-fourth of the cruzeiro equivalent of their proceeds released to the borrower immediately. The remainder of the proceeds is deposited with the Central Bank under conditions similar to those required for Resolution 432 deposits, i.e., the Central Bank pays the interest on the deposit and bears the risk of exchange loss until the stipulated deposit period expires. Under Resolution 432, none of the proceeds are released for 120 days, but under Resolution 595, one-third of the proceeds from such foreign currency loan deposits will be released sixty days after deposit; one-third will be released after ninety days; and the final one-third of the proceeds will be released after 120 days.

Central Bank Resolution No. 613

Since 1975 the Brazilian government has been attempting to reduce the effective interest rate on foreign loans by rebating to the Brazilian borrower a portion of the 25 percent Brazilian withholding tax levied on interest income. Central Bank Resolution No. 335 of August 5, 1975 granted Brazilian borrowers with duly registered foreign currency obligations a rebate of 85 percent of the withholding tax on interest income, provided that, in the case of import financing loans, the minimum term was five years. Central Bank Resolution No. 559 of July 26, 1979 reduced this tax rebate from 85 percent to 50 percent and increased the minimum term of eligibility for import-financing transactions from five to eight years. Central Bank Resolution No. 587 of December 7, 1979 increased the tax rebate from 50 percent to 95 percent of the withholding tax. On May 8, 1980, the Central Bank once again decided to reduce this tax rebate from 95 percent to 40 percent.

The latest decrease in the rebate rate from 95 percent to 40 percent has the effect of increasing the cost of foreign loans to the Brazilian borrower by an average of approximately 1½ to 3 percent. On the other hand, the measure also increases the percentage of Brazilian tax creditable for United States tax purposes, thereby making loans to Brazilian borrowers more attractive to United States lenders.

One can justifiably conclude from the brief account of recent legislation described above that the rules of the Brazilian credit operations game are in a constant state of flux and require the concentrated attention of counsel.

Governmental Regulations and Requirements

Appendix B summarizes the principal governmental requirements presently in effect concerning foreign loans in Brazil. Requirements are classified by the type of borrower, e.g. private or public sector entities, and by the use to which the loan proceeds are applied, e.g., foreign currency loans for use in Brazil and import financing transactions. The material below just emphasizes some of the more significant details of the requirements summarized in Appendix B.

The guarantee of the federal government is an important factor in most loans made by foreign lenders to public sector borrowers. Indeed, it is reasonable to conclude that most foreign loans would not be made to state enterprises—with the possible exception of such highly regarded companies as *Petróleo Brasileiro S.A. (PETROBRÁS)* and *Companhia Vale do Rio Doce*—without either the guarantee of payment by the Brazilian federal government of the related promissory notes (*aval*) or its contractual guarantee (*fiança*). All loan transactions involving the guarantee of the federal government are subject to special legislation¹ that should be closely scrutinized by counsel.

Although foreign currency loans generally fall within the scope of Law No. 4,131 of September 3, 1962, and thus are subject to similar regulations governing minimum term, i.e., eight years; grace period i.e., thirty months; compulsory deposit; and income tax rebate, two special subcategories of foreign currency loans are worth special mention—Resolution 63 loans and Resolution 229 loans.

Central Bank Resolution No. 63 of August 21, 1967 provides for foreign loans to Brazilian commercial and investment banks, which in effect are borrowing abroad on behalf of other Brazilian borrowers who will receive the cruzeiro equivalent of such loans. It should be noted that unlike ordinary Law 4,131 loans, the federal government of Brazil guarantees the convertibility of all Resolution 63 loans.

Central Bank Resolution No. 229 of September 1, 1972 allows foreign loans to be extended or passed on to borrowers for periods as short as eighteen months, provided that the proceeds of such loans remain in Brazil under the conditions originally approved by the Central Bank, e.g., a thirty months' grace period and a minimum eight year term. If the foreign lender leaves loans on deposit with the Central Bank during the original term of the loan authorized by the Central Bank, the Bank will pay interest at the London interbank market rate without any spread.

The major difference between import financing transactions and foreign currency loans is that the former are not subject to any minimum grace period and term² except as relevant to such tax considerations as the income tax rebate discussed above and certain exemptions from the 25 percent withholding tax on interest remitted abroad. In addition, the Central Bank uses a different regulatory terminology for import financing transactions, to wit: "certificate of authorization" in lieu of the "FIRCE-10 Approval"; and "schedule of payments" instead of "certificate of registration." The interest rate allowed by the Central Bank for import financing loans with a

¹See, *inter alia*, Decree-Law No. 1,312 of February 15, 1974, *as amended*; Decree No. 76,382 of September 8, 1976; Decree No. 84,128 of October 29, 1979; Decree No. 65,071 of August 27, 1969.

²Subsequently modified by Central Bank Resolution No. 638 of September 24, 1980.

term of less than 360 days is limited to a certain spread above the London interbank rate or the applicable prime rate, as the case may be. This spread is presently zero for transactions of less than 180 days; .25 percent per annum for 180-270 day transactions; and .5 percent per annum for transactions between 270 and 360 days.³ It should be noted that the importation of certain items is subject to special prior approval by specific governmental agencies. For example, the acquisition and financing of new or used aircraft must be approved by both the Civil Air Transport Commission (*Comissão de Transporte Aéreo Civil*) and the Ministry of Aeronautics, and the importation of computer equipment and data processing materials must be approved by a special governmental agency regulating this area (*Comissão Coordenadora das Atividades de Processamento Eletrônico—CAPRE*).

If the Brazilian borrower is a state or municipality, three additional governmental authorizations normally are required: (1) a law of the legislative body of the state or municipality, as the case may be, authorizing the executive branch thereof to negotiate and contract the loan; (2) a resolution of the federal senate authorizing the credit operation in accordance with Article 42 (IV) of the federal constitution; and (3) the opinion of the Secretariat of Cooperation with the States and Municipalities (SAREM) recognizing the degree of priority of the specific project or program being financed by the loan and the ability of the borrower to repay the loan. This opinion is issued in lieu of the opinion issued by SEST pursuant to Decree No. 84,128 for other types of loans.

If a credit operation is secured by either a pledge agreement or a mortgage, the pledge agreement should be duly registered with the competent Registry of Instruments and Documents and the mortgage should be duly registered with the competent Real Estate Registry.

In summary, the practicing lawyer interested in international financial transactions involving Brazil should be constantly on the alert for changes in the regulations and policies governing foreign loans and their negotiation by Brazilian borrowers. In addition, counsel should study closely the actual application and effect of any such regulations and policies on a particular credit operation, because many times there exists a large gap between what is written and what is required.

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³Cf. Central Bank Circular No. 306 of February 7, 1979, as amended Decam Communiqué No. 259 of November 25, 1980.

Appendix A*

Decree No. 84,128 of October 29, 1979 provides for the control of resources and expenditures of government companies and other pertinent measures.

The President of the Republic, by virtue of the powers granted to him by Article 81 (III) and (V) of the Constitution, and in view of the provisions of articles 18, 23, 36, 38 and 93 of Decree-Law No. 200 of February 25, 1967 and article 7 of Law No. 6,036 of May 1, 1974,

Decreases:

Article 1—The control of resources and expenditures of state enterprises, instituted by this Decree, is included among the Subsystems of the Federal Planning System, dealt with in Decree No. 71,353 of November 9, 1972.

Article 2—The following are considered state enterprises for the purposes of this Decree:

- I— public enterprises, mixed capital companies, their subsidiaries, and all enterprises controlled, either directly or indirectly, by the federal government;
- II— agencies and foundations established or maintained by the Government;
- III— autonomous organs of Direct Administration (Decree-Law No. 200 of 1967, article 172).

Sole Paragraph—Private law entities and organizations which receive subsidies or transfers from the Federal Budget and render services of public or social interest, with due observance of the provisions of article 183 of Decree-Law No. 200 of February 5, 1967 and Decree-Law No. 772 of August 19, 1969, shall be treated as the equivalent of state enterprises, for purposes of governmental control set forth under this Decree.

Article 3—The Secretariat of Control of State Enterprises (SEST) is created as a central organ of the Subsystem provided for in article 1 and is part of the Secretariat General, within the basic structure of the Planning Secretariat of the Presidency of the Republic, referred to in article 2(III) of Decree No. 73,627 of February 13, 1974.

Article 4—The Secretariat of Control of State Enterprises (SEST) is authorized:

- I— To coordinate, by virtue of delegation from the Minister of State-Chief of the Planning Secretariat of the Presidency of the Republic (SEPLAN), state enterprises' activities involving resources and total expenditures which can be adjusted through governmental programming, keeping in mind the objectives, policies and directives of the National Development Plan;
- II— To advise the Secretary General of the Planning Secretariat of the Presidency of the Republic (SEPLAN) on matters relating to the Subsystem:
 - (a) in the normative guidance of the central organ of the Planning System (Decree No. 71,353 of 1972, articles 4 and 5);
 - (b) in the issuance of instructions necessary for the operation of the Accompanying Program of the National Development Plan (Decree No. 70,852 of 1972, article 3);

*Translated by João Figueiredo, Karlos Rischbieter and Delfim Netto.

- (c) in the annual elaboration of the General Applications Program (Decree No. 70,852 of 1973, article 4);
- III— To prepare, based on information supplied by the state enterprises, proposals for setting up maximum limits on total expenditures, for the approval of the President of the Republic, in the area of the Council on Economic Development (CDE);
- IV— To supervise the management of state enterprises with regard to their efficiency, performance, operations, economic profitability and financial-economic status;
 - V— To issue opinions on recognizing the priority of specific projects or programs and the prospective borrower's ability to repay, for the purpose of contracting foreign loans by state enterprises, as well as by organs of Federal Direct Administration and decentralized entities of the Administration of States, the Federal District, Municipalities and Territories;
- VI— To assist the Special Secretariat of Supplies and Prices of SEPLAN (Decree No. 84,025 of 1979) in establishing or readjusting the prices and tariffs of goods or services of state enterprises;
- VII— To propose criteria, subject to the approval of the President of the Republic, within the area of the Council of Economic Development (CDE) for the determination or readjustment of the remuneration of the directors of state enterprises, with due observance of the applicable legislation;
- VIII— To prepare proposals for the determination of the total limits of value to be approved by the President of the Republic, within the scope of the Council of Economic Development (CDE), for direct importation of goods and services and for purchase, rental or leasing of goods of foreign origin in the domestic market, by state enterprises and organs of Federal Direct Administration;
- IX— To prepare proposals to determine total limits, to be approved by the President of the Republic, within the scope of the National Development Council (CDE), for the purchase of fuel for automotive vehicles, by state enterprises and organs of the Federal Direct Administration;
- X— To control the collection of the results attributable to the Federal Government verified in the annual balance sheets of public enterprises and the federal mixed economy groups referred to in Decree-Law No. 1,521 of January 26, 1977;
- XI— To make known its views with respect to any proposals for the increase of capital and issuance of convertible or nonconvertible debentures of state enterprises, prior to submission of such proposals to the President of the Republic;
- XII— To issue opinions on any proposals for creating state enterprises or for assumption of control of them by private enterprises, as well as for the liquidation or merger of decentralized entities in critical economic-financial straits (Decree-Law No. 200, article 178), before submitting such proposals to the President of the Republic;
- XIII— To organize systematically and maintain an up-to-date National Survey of State Enterprises;
- XIV— To carry out any assignments or missions assigned to it by the Minister of State-Chief of the Planning Secretariat of the Presidency of the Republic or by its Secretary General.

Article 5—The head of the Secretariat of Control of State Enterprises (SEST) will be the representative of the Minister of State-Chief of the Planning Secretariat of the Presidency of the Republic in the event of the latter's absence at the meeting of the National Council on Salary Policy.

Article 6—The Secretariat of Control of State Enterprises shall exercise control over and supervise the specific activities of the organs of the Subsystem, with due regard for the supervision by each Minister of State over the state enterprises within his respective area of control.

Sole Paragraph—The governmental representatives (and members of their staffs) to the shareholders' meetings of state enterprises, as well as on administrative organs, auditing committees, or similar agencies of such enterprises shall supply and shall be held responsible for their failure to supply, all information and data requested from them for purposes of the control referred to in this article.

Article 7—The Foreign Loan Commission (CEMPEX) created by Decree No. 65,071 of August 27, 1969, is hereby abolished. Its functions and powers are transferred to the Secretariat of Control of State Enterprises (SEST) with due observance of the following paragraphs:

Paragraph 1—It shall be incumbent on the Central Bank to accredit firms interested in contracting foreign loans with a view towards the initiation of negotiations with foreign financial entities, in the cases contemplated under article 2(I) of Decree No. 65,071 of August 27, 1969.*

***TRANSLATOR'S NOTE.**

These cases are:

- (a) where the prospective lender is an agency of a foreign government or an international organ;
- (b) where Brazilian governmental entities, including mixed capital companies, are involved; or
- (c) where the loan is to be guaranteed by the National Treasury, either directly or indirectly, through some other federal credit agency.

Paragraph 2—The accreditation referred to in the previous paragraph requires the prior and express authorization of the Minister of State-Chief of the Planning Secretariat of the Presidency of the Republic, in the cases mentioned under articles 4(V) and 8 of this Decree, as well as in operations contemplating the cosignature or guarantee of the National Treasury or any official federal credit entity in the name of the National Treasury.

Article 8—For the purpose of the contracting of foreign loans by organs of Direct Administration of the States, Federal District, Municipalities and Territories, the Secretariat of Cooperation with the States and Municipalities (SAREM) is authorized to issue its opinion on recognition of the priority of the specific project or program and the prospective borrower's ability to repay.

Article 9—The function of confidence of Secretary of Control of State Enterprises, Code LT-DAS-1014, is hereby included in the Permanent List of the Planning Secretariat of the Presidency of the Republic, as provided under Decree No. 79,208 of February 7, 1977 for the composition of the Superior Direction Category, Code LT-DAS-101, of the Superior Direction and Counseling Group, Code LT-DAS-100.

Article 10—The expenses stemming from the implementation of this Decree shall be covered by the funds of the Secretariat of Planning of the Presidency of the Republic.

Article 11—The Minister of State-Chief of the Planning Secretariat of the Presidency of the Republic may issue additional rules to implement the provisions of this Decree.

Article 12—This Decree shall go into effect on the date of its publication. All provisions to the contrary are hereby revoked.

Appendix B

Principal Governmental Requirements Concerning Foreign Loans in Brazil

- I. Principal Governmental Requirements Relating to a Foreign Currency Loan Made to a Public Sector Borrower With the Guarantee of the Federative Republic of Brazil.
 - A. Authorization of the Secretariat of Planning of the Presidency of Brazil (SEPLAN) to enter into negotiations relating to the terms of the loan.
 - B. Authorization of Banco Central do Brasil (Central Bank) regarding the negotiation of the loan.
 - C. Opinion of the Secretariat of Control of State Enterprises (SEST) recognizing the degree of priority of the specific project or program being financed by the loan and the ability of the borrower to repay the loan.
 - D. Statement by the Minister-Chief of SEPLAN concerning the priority within national development plans and programs of the specific project or program for which the borrower will utilize the proceeds of the loan and the borrower's ability to repay the loan.
 - E. Opinion of the Office of the Attorney General of the National Treasury, addressed to the Minister of Finance, recommending the issuance of the Federal Government's guarantee.
 - F. Decree issued by the President of Brazil authorizing the Minister of Finance to grant the guarantee of the Federative Republic of Brazil.
 - G. Authorization of the Minister of Finance approving the loan and guarantee and authorizing certain individuals to execute and deliver the loan agreement and the promissory notes for and on behalf of the guarantor.
 - H. Prior approval of the terms of the loan by the Department of Foreign Capital Supervision and Registration (FIRCE) of the Central Bank (the "FIRCE-10 Approval").
 - I. Certificate of registration issued by the Central Bank.
 - J. Summary of the principal terms and conditions of the loan, as published in the *Diário Oficial da União*.
- II. Principal Governmental Requirements Relating to a Foreign Currency Loan made to a Private Sector Borrower Without any Governmental Guarantee.
 - A. Authorization of the Central Bank regarding the negotiation of the loan, but only if the prospective lender is an agency of a foreign government, e.g., the Export-Import Bank of the United States, or an international organ, e.g., the Interamerican Development Bank.
 - B. FIRCE-10 Approval.
 - C. Certificate of registration issued by the Central Bank.
- III. Principal Governmental Requirements Relating to an Import Financing Loan made to a Public Sector Borrower Without the Guarantee of the Federative Republic of Brazil.
 - A. Authorization of the Secretariat of Planning of the Presidency of Brazil (SEPLAN) to enter into negotiations relating to the terms of the loan.
 - B. Authorization of Banco Central do Brasil (Central Bank) regarding the negotiation of the loan.
 - C. Opinion of the Secretariat of Control of State Enterprises (SEST) recognizing

the degree of priority of the specific project or program being financed by the loan and the ability of the borrower to repay the loan.

- D. Statement by the Minister-Chief of SEPLAN concerning the priority within national development plans and programs of the specific project or program for which the borrower will utilize the proceeds of the loan and the borrower's ability to repay the loan.
- E. Evidence that the loan falls within the borrowing limits approved by the President of Brazil.
- F. Certificate of Authorization issued by the Central Bank authorizing the borrower to (1) apply for the necessary import licenses; and (2) obtain and remit foreign currency from Brazil for the purpose of paying, during the period preceding issuance of the Schedule of Payments referred to in paragraph H below, interest on the principal of the loan (including all exchange fees and costs), the commitment, agency and management fees, if any, and all expenses provided for in the loan agreement.
- G. Import licenses (*guias de importação*) issued by the Foreign Trade Section of Banco do Brasil S.A. (CACEX) covering the items financed by the loan.
- H. Schedule of Payments issued by the Central Bank after the last item financed by the loan has been imported into Brazil authorizing the borrower to obtain and remit foreign currency from Brazil for the purpose of paying the principal of and interest on the loan.

IV. Principal Governmental Requirements Relating to an Import Financing Loan Made to a Private Sector Borrower Without any Governmental Guarantee.

- A. Authorization of the Central Bank regarding the negotiation of the loan, but only if the prospective lender is an agency of a foreign government, e.g., the Export-Import Bank of the United States of America, or an international organ, e.g., the Interamerican Development Bank.
- B. Certificate of Authorization issued by the Central Bank authorizing the borrower to (1) apply for the necessary import licenses, and (2) obtain and remit foreign currency from Brazil for the purpose of paying, during the period preceding issuance of the Schedule of Payments referred to in paragraph III below, interest on the principal of the loan (including all exchange fees and costs), the commitment, agency and management fees, if any, and all expenses provided for in the loan agreement.
- C. Import licenses (*guias de importação*) issued by the Foreign Trade Section of Banco do Brasil S.A. (CACEX) covering the items financed by the loan.
- D. Schedule of Payments issued by the Central Bank after the last item financed by the loan has been imported into Brazil authorizing the borrower to obtain and remit foreign currency from Brazil for the purpose of paying the principal of and interest on the loan.