The Lending and Secured Finance Review

Editor
Azadeh Nassiri

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EDITOR'S PREFACE

This first edition of *The Lending and Secured Finance Review* comes on the heels of a strong few years for the loan markets. During this period, despite some volatility and bumps in the road, lending conditions have generally continued to improve against a backdrop of greater economic stability and the return of M&A activity in Europe and globally.

It is difficult to ignore, however, that there has been a significant change in the way corporates access funding since the financial crisis and that diversification of financing sources (both in terms of products and markets) has been a key global trend for corporate treasurers. Unable to rely to the same extent as previously on their relationship lenders, and with liquidity in the European loan markets constrained, many corporate treasurers turned to the debt capital markets in the aftermath of the financial crisis and, in particular, the US high-yield and private placement markets. This trend has continued, driven in part by new regulatory reforms increasing capital requirements for banks, as well as new industry regulations and guidance impacting the leverage multiples that some banks are able to offer.

Nonetheless, loans (secured and unsecured) remain the predominant source of funding for corporates globally. While traditional banks still play an important and active role in the loan markets and remain dominant in the investment grade market, in other sectors (particularly in the leveraged, real estate and infrastructure finance markets) institutional investors, many of whom also participate in the debt capital markets, are more prominent. The last few years have also seen the rise of alternative finance providers such as direct lending funds, particularly in the mid-market.

The combination of the competition from these alternative finance providers and the high-yield market, the willingness of US investors to invest in European assets and the convergence of the European and US markets more generally, especially in the leveraged space, has resulted in a crossover of US terms and structures (particularly from the high-yield and term loan B markets). It is now not uncommon, for example, to see call protection included for term loans in a leveraged facility agreement and since

2013, covenant-lite and covenant-loose loans have re-emerged to become a reasonably significant feature of the European loan market.

It is difficult to predict how the markets will fare, in particular given underlying concerns about the depth of the global economic recovery, but growth of direct lending funds, private placements and other alternatives to traditional loan finance seems set to continue. It will be interesting to see whether competition from these alternative sources and the high-yield and term loan B markets will result in further crossover of US terms into the European leveraged loan market, including the mid-market. It will also be interesting to see how banks and other investors continue to react to the changing regulatory landscape and the political and economic risks and uncertainties in certain parts of the eurozone and the emerging markets.

The Lending and Secured Finance Review contains contributions from leading practitioners in 14 different countries and I would like to thank each of the contributors for taking the time to share their expertise on the developments in the corporate lending and secured finance markets in their respective jurisdictions and on the challenges and opportunities facing market participants. I would also like to thank our publishers, and in particular Nick Barette, Shani Bans and Adam Myers, without whom this publication would not have been possible.

I hope that the commentary that follows will serve as a useful source for practitioners and other readers.

Azadeh Nassiri
Slaughter and May
London
August 2015

Chapter 1

BRAZIL

Bruno Balduccini and Roberto Panucci Filho[1]

I OVERVIEW

The volume of credit in the Brazilian financial market has grown more than 500 per cent in the last 10 years, reaching 3,081 billion reais at the end of 2014, which represented 54.4 per cent of the Brazilian GDP.[2]

Despite the liberalisation of the last decades, local financial institutions dominate the Brazilian markets. The major lenders in Brazil are local private and public banks and the Brazilian Federal Development Bank (BNDES). Foreign-owned banks also play an important role in the financial markets, but mainly in the corporate lending activities.

The BNDES played a very important role, providing subsidised financing to many infrastructure projects, including projects related to the World Cup 2014 and the Olympic Games 2016. Due to the fiscal austerity programme put in place in 2015 to prevent a recession, the Brazilian government recently announced restrictions to BNDES-subsidised financing to large companies. Such a restriction will likely lead to an increase in loan transactions carried out by private banks.

The most important lending transaction in 2014 was the financing of power distributors who were struggling due to government-controlled retail prices. Pinheiro Neto Advogados advised 13 banks in three complex syndicated loans to power distributors in Brazil, for a total amount of 21 billion reais.

In order to make such loans possible, the Brazilian government and the banks developed an unprecedented financial and legal structure.

Besides that, it is worth mentioning that peer-to-peer lending is starting to grow in Brazil, and a few companies are already conducting such business.

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1 Bruno Balduccini is a partner and Roberto Panucci Filho is an associate at Pinheiro Neto Advogados.

2 Source: Central Bank of Brazil.

II LEGAL AND REGULATORY DEVELOPMENTS

i Basel III

The Brazilian financial sector can be considered large, solid, sophisticated and heavily regulated. The Central Bank of Brazil is responsible for implementing the monetary and credit policies drawn up by the National Monetary Council (CMN), to regulate foreign exchange transactions, as well as to supervise financial institutions.

Banking supervision in Brazil is risk-based, intrusive and sophisticated and already had a high degree of compliance with Basel II in the early 2000s. Accordingly, and due to that, Brazilian financial institutions passed through the financial crisis that began in 2008 extraordinarily well.

The CMN and Central Bank have strengthened regulations further in 2013, regulating the implementation of Basel III on a gradual basis. These regulations address, among other aspects:

a the calculation of capital requirements;
b criteria for eligibility of instruments such as Tier 1 or Tier 2 Capital;
c calculation methodology for regulatory capital;
d the introduction of capital buffers; and
e transition periods for the application of new rules.

The Central Bank may reduce or prohibit the payment of dividends by financial institutions that do not comply with such capital requirements.

In 2014 and 2015, the CMN and the Central Bank issued additional regulations related to, among other things, Basel III framework regarding additional core capital required and leverage coverage ratio.

The implementation of Basel III will likely have a limited impact on financial institution and on lending, because the banking system reports high levels of capitalisation, liquidity and profitability.[3] In December 2014, Brazilian banks in general were capitalised above regulatory minimum levels. The average Basel capital adequacy ratio was 16.7 per cent, complying with Basel III standards. The leverage ratio (7.1 per cent) and the liquidity ratio based on a liquidity buffer or stressed cash flow (2.02 per cent) were also prudentially adequate. The return on equity of the banking system was 13 per cent per annum.[4]

ii Improvement of debt collection

In recent years, Brazil has passed laws to improve lending, collateral and debt collection. One of the most important factors to enhance debt collection and to increase lending transactions has been the reform of the Bankruptcy and Judicial Recovery Law in 2005, since it establishes the priority of bank credits over tax credits and expressly sets forth

3 In 2013, the Director of Financial System Regulation of the Central Bank, Mr Luiz Awazu Pereira da Silva, announced that Brazilian banks would not require additional capital to comply with Basel III before 2017 and that Basel III would not impact credit offers in Brazil.

4 Source: *Relatório de Estabilidade Financeira*, published by the Brazilian Central Bank.

that certain credits are bankruptcy-remote. The result is a more efficient debt collection process, especially for home loans and vehicle financing.

The new Code of Civil Procedure, which seeks to discourage procrastinating measures and improve legal certainty, shall also reduce legal risk and improve debt collection. Such law was enacted in 2015 and will become effective in the following year – results are not immediate, but should be known in the near future.

iii Anti-corruption framework

Brazil has made considerable efforts to improve its anti-corruption framework recently, with the objective to fulfil international commitments undertaken by Brazil in anti-corruption treaties, as well as to address heavy popular pressure after scandals involving politicians. Three improvements have been remarkable:

a Law No. 12,846/2013 (the Anti-Corruption Act);
b Law No. 12,850/2013; and
c stricter prosecution.

Before the Anti-Corruption Act, only individuals could be held liable for corruption. The Anti-Corruption Act became effective in 2014, providing strict corporate civil and administrative liability for wrongful acts against local or foreign public administration. Before such act, only individuals could be held liable for corruption. Violations to the Anti-Corruption Act result in:

a fines that range from 0.1 per cent to 20 per cent of the revenues of the company involved in the violation;
b confiscation of assets;
c suspension or partial shutdown of activities;
d dissolution of the legal entity; and
e prohibition from receiving incentives or subsidies from public entities.

The anti-corruption framework was also improved by Law No. 12,850/2013, which created whistle-blower incentives, and by stricter investigation and prosecution by local authorities. In view of the foregoing, Brazilian companies are more concerned with compliance practices and lenders are aware that violations to the Anti-Corruption Act may cause material impact to borrowers' cash flow.

III TAX CONSIDERATIONS

This section provides for a high-level summary on the key aspects related to the Brazilian tax regime, generally applicable to cross-border loan transactions, and more specifically to loans granted by foreign entities to Brazilian companies. The tax treatment of loan transactions granted by local banks is more complex and substantially different to cross-border loans.

Under Brazilian tax legislation, foreign loan transactions may be subject to the assessment of two main taxes: tax on financial transaction (IOF) and withholding income tax (WHT). While the former tax assesses foreign exchange transactions carried out for the inflow or outflow of funds to and from Brazil, with rates varying in accordance with

the type of transaction that has caused the entry or exit of funds, the latter is generally levied upon interest payable by the Brazilian party to the foreign lender.

As a rule, the taxpayer of IOF in cross-border loan transactions is the Brazilian borrower. Nonetheless, the Brazilian financial institution has the burden to collect IOF owed by the Brazilian borrower, and pay such tax to the federal government.

For foreign loans granted to Brazilian companies, current IOF regulations determine that a 6 per cent flat rate shall apply on the inflow of funds into the country if the minimum average maturity term of the loan is equal to or lower than 180 days. Otherwise, if a foreign loan is granted for a higher term, such 6 per cent rate upon the entrance of the resources into the county is reduced to zero. If the loan enters into the country expecting to comply with the minimum average term for benefiting from the reduced IOF rate, but for any reason the Brazilian borrower fails to meet such minimum requirement, the IOF will be considered due at a 6 per cent rate as from the date of the inflow of the corresponding funds, with a 20 per cent late-payment penalty and interest on arrears based on the Special Clearance and Escrow System rate (currently approximately 13 per cent per annum) also being applied.

IOF may also be levied in case of renegotiation of loan transactions. Brazilian foreign exchange regulation sets forth that certain types of amendments of the terms and conditions of foreign loans (such as an assignment of credit) require the execution of 'simultaneous foreign exchange transactions' (i.e., foreign exchange transactions that are contractually entered into as though the original loan was repaid and a new loan would be executed between the parties, even though no actual flow of funds would take place). In view of that, it is necessary to assess whether a renegotiation requires a simultaneous foreign exchange transaction and whether IOF is applicable to each part of such transaction. It is worth mentioning that, within certain limits, the IOF can be changed by the Brazilian government at any time, with no need of a prior approval from Congress.

In addition to the IOF, the amounts paid as interest abroad are subject to WHT at a 15 per cent rate. There are two main exceptions to such rule:

a if the beneficiary of the interest is on a jurisdiction blacklisted by the Brazilian tax regulation as a tax haven, the applicable rate will be 25 per cent; and

b if the beneficiary of the interest is domiciled in Japan or is a branch of a Japanese bank in other jurisdiction, the applicable rate will be 12.5 per cent.

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b if the beneficiary of the interest is domiciled in Japan or is a branch of a Japanese bank in other jurisdiction, the applicable rate will be 12.5 per cent.

The Brazilian borrower will be held responsible for withholding and paying WHT upon the interest paid, credited, delivered, used or remitted to the lender. This tax should be discounted from the gross amounts to be paid abroad, so that if the borrower wishes to receive the actual amounts charged without reductions for taxes collected in Brazil, the tax base on the interest payments should be grossed up accordingly.

In principle, interest paid by a Brazilian borrower to a foreign lender on foreign loans is deemed to be tax-deductible. Certain limitations apply to transactions entered between related parties, such as the Brazilian transfer pricing and thin capitalisation rules.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

This section provides an overview of the common methods of taking securities over different types of assets in Brazil.

In Brazil, the following methods of credit support are available:

a *in rem* guarantees;
b personal guarantees;
c contract bonds;
d standby letters of credit or demand guarantees; and
e aval on promissory notes.

Brazilian law does not provide any specific restriction to take security over all or substantially all of the assets of a debtor or guarantor. Notwithstanding, it is not possible to document such security interest in a single document, since *in rem* guarantees need to be registered before different authorities depending on the type and location of asset granted as collateral (registration with the competent authorities is a condition for perfection of such security interests).

Fiduciary sale, mortgage and pledge are *in rem* guarantees. *In rem* guarantee creates a privilege over the collateral in favour of the creditor, being the asset granted in collateral bound to the secured obligation. In such case, creditors do not have recourse against the guarantor that provided an *in rem* guarantee to collect outstanding amounts after the foreclosure of the collateral, unless agreed otherwise.

The most common types of *in rem* guarantees are the fiduciary sale, mortgage and pledge.

The fiduciary sale is a type of security interest pursuant to which the guarantor assigns to the creditor the title of certain assets. Therefore, the guarantor continues to have the possession of such assets, still being liable for the duties of an escrow agent or bailee, or a trust in relation to them. Title of such asset granted in fiduciary sale is only given back to guarantor when latter has fulfilled all of its obligations under the guaranteed credit.

The fiduciary sale was introduced in Brazil in 1965, but the applicable legal framework changed in the early 2000s with the enactment of a new Civil Code and other laws. Such modifications fostered the use of fiduciary sale, which is currently one of the main credit support transactions, especially because of its bankruptcy remoteness feature. Since a fiduciary sale entails the transfer of the ownership of the underlying assets to the

creditors, the creditors are not exposed to the risks inherent to a guarantor's bankruptcy.[5] That is the main difference between a fiduciary sale and the other guarantees, which do not entail the transfer of ownership of collateral and therefore the creditor may be subject to bankruptcy apportionment of the guarantor.

There are two regimes applicable to fiduciary sales. On one side, Law 4,728/65 and Law 10,931/04 regulate fiduciary sales within the scope of the financial and capital markets, expressly allowing the fiduciary sale of fungible[6] and non-fungible property and credit rights. On the other side, the Brazilian Civil Code applies to fiduciary sales that are not within the scope of the abovementioned markets. Although the Brazilian Civil Code does not have any provision regarding the characteristics of the asset given as collateral in a fiduciary sale, there are precedents of the Brazilian Superior Court of Justice narrowing the fiduciary sale under such law to non-fungible assets.[7] Since foreign lenders do not qualify as financial institutions under Brazilian law, it is disputable whether or not a transaction with such entities would qualify as a transaction within the scope of the financial or capital markets and, therefore, it is also disputable that such entities could benefit from a fiduciary sale of fungible assets or credit rights.

Pledges and mortgages are also commonly used as collateral in lending transactions, with pledges being applicable to moveable assets and rights (e.g., machinery, inventory, vehicles, credits and shares) and mortgages to non-moveable assets (e.g., real estate). Different from the fiduciary sale, in pledges and mortgages the guarantor keeps the title of the collateral and, therefore, creditors may be affected by the bankruptcy of the guarantor. In addition to that, pledges and mortgages are subject to multiple liens (first, second, third priority or more), therefore the creditor may not necessarily receive a first priority security interest with respect to a particular asset if such asset has already been encumbered in favour of another creditor. Fiduciary sale is not subject to multiple liens (since it involves a transfer of ownership to the creditor).

Brazilian law forbids the creditor to keep or obtain title of collateral in case of default (prohibition of *commissoria lex*), unless the guarantor grants express consent after the maturity date of the debt or its acceleration. In view of that, if the guarantor does not grant such consent, the collateral should be sold at a public auction, the proceeds of which will be applied to the payment of the principal and interest of the debt, judicial

5 Bankruptcy and Reorganisation Law: assets granted by means of fiduciary arrangements can have their foreclosure suspended for a period of 180 days (stay period) should the judge consider such assets as being essential for the company's activities. An asset may be considered 'essential' if the guarantor cannot perform its activities without it or when the performance of such activities is jeopardised in the absence of such asset. Brazilian courts tend not to hold financial assets and investments as essential asset, but this analysis must always be done on a case-by-case basis, since it depends on the business of the guarantor.

6 Regarded as commercially interchangeable with other property of the same kind.

7 Special Appeal No. 1.101.375, decided on 4 June 2013; Special Appeal No. 346.240, decided on 30 August 2002; and Special Appeal No. 97.952, decided on 6 April 2000.

expenses and legal fees, provided that in case of attachment of quotas or shares[8] requested by a creditor who is not a shareholder or partner (as the case may be) of the company, the company shall be summoned for the purposes of securing the right of first refusal of its shareholders or partners.[9] In any case, the balance amount (surplus), if any, shall be returned to the guarantor.

ii Guarantees and other forms of credit support

Besides *in rem* guarantees, lending transactions may be secured by personal guarantees. Under Brazilian law, a personal guarantee is likely to be perceived as a surety and may be defined as a contract of a person or corporate entity by which one guarantees, in whole or in part, the performance of an obligation of someone else.

In summary, under Brazilian law:

a personal guarantees may encompass the principal amount and ancillary charges (monetary correction, interest and other fees);

b personal guarantees are granted by guarantor and do not require the debtor's prior consent;

c if the personal guarantee is granted by a married individual, consent of the spouse is required; and

d the guarantor has a series of benefits granted by law, which are generally waived by the parties.

Contract bonds are a type of insurance wherein the insurance company guarantees the performance of the insurance taker's (debtor) underlying obligations under the lending agreement by providing the funds for the insured party to contract another company to perform the insured obligations. Local companies or individuals domiciled in Brazil shall take out insurance coverage before local insurers for risks run in Brazil. There are a few exceptions to this rule; for example, local companies or individuals are allowed to take out insurance coverage abroad if the insurance in question is not offered by local insurance companies.

Standby letters of credit and demand guarantees are also used to guarantee loan transactions. Brazilian banks and affiliates of international banks in Brazil in general do not issue standby letters of credit or demand guarantees for local transactions. Such guarantees are usually issued in connection with cross-border transactions or by financial institutions headquartered abroad.

8 Brazilian law presently in force does not expressly contemplate the creation of pledge of quotas of a limited liability company (*sociedade limitada*). However, such pledge of quotas has been accepted by Brazilian courts based on provisions of law relating to pledge of rights, contract rights and Law No. 6,404/76, as amended.

9 In certain cases, the transfer of shares/quotas may be subject to antitrust clearance and in case the new other owner is a foreign entity, there are certain formalities to be observed by such foreign entity before the Central Bank of Brazil.

Promissory notes are documents that represent amounts owed. Although promissory notes are not considered additional guarantees for the payment of debts, they are used to represent amounts owed under the lending transaction, and the debt stated in the promissory note may be guaranteed by a third party by means of an aval guarantee. Any legal entity or individual may issue a promissory note or grant an aval guarantee (additional requirements may be applicable if the aval guarantee is granted by individuals).

iii Priorities and subordination

In case of bankruptcy liquidation, certain credits are excluded from bankruptcy apportionment, such as assets granted in a fiduciary sale, post-petition claims and certain labour claims. After those credits are paid, the balance of the funds received from the liquidation of the assets must be used to pay the pre-petition claims, in accordance with the following order:

a labour-related claims, limited to 150 minimum wages per creditor, and occupational accident claims;
b secured claims, up to value of the collateral;
c tax claims, except for tax fines;
d special priority claims;
e general priority claims;
f unsecured claims;
g contractual penalties and monetary penalties for breach of criminal or administrative law, including tax law; and
h subordinated claims.

Exception is made for a fiduciary sale, which is bankruptcy remote and is therefore not subject to such list of priorities.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal reservations

Lending transactions and collateral may be limited by the validity of the underlying obligation, since under Brazilian law guarantees are considered an accessory duty to the underlying obligation, and the nullity of the principal obligation causes the nullity of all the accessories obligations. Such limitations are not applicable to independent guarantees, such as standby letters of credit, demand guarantees and to aval guarantees on promissory notes.

In addition, bankruptcy, governmental intervention, extrajudicial liquidation, insolvency, fraudulent transfer, judicial and out-of-court reorganisation procedures may impact lending transactions and guarantees (an exception is made for the independent guarantees listed above and for contract bonds).

The Brazilian Bankruptcy Law governs the insolvency proceedings involving companies and corporations and provides three procedures to address insolvency situations, as follows:

a judicial reorganisation;

b out-of-court reorganisation or prepackaged reorganisation; and
c bankruptcy liquidation.

Judicial and prepackaged reorganisations are similar, respectively, to Chapter 11 and prepackaged arrangement under the US Bankruptcy Code. Creditors holding pre-bankruptcy claims are subject to reorganisation and generally precluded to enforce their credit rights against the debtor. Initially, claims are also not enforceable during the stay period in a judicial reorganisation proceeding. Further, in a scenario where the plan of reorganisation or prepackage plan is confirmed, creditors will be bound by such plans (payment terms and respective rights will be governed by the respective instrument). In a bankruptcy scenario, creditors are subject to bankruptcy apportionment of the guarantor.

ii Opinions practice

Brazilian law does not require lenders or borrowers to obtain legal opinions to enter into loan transactions, but such documents may be used to ensure that directors and officers have complied with their fiduciary duties, and to provide comfort to borrowers entering into the transaction.

Legal opinions are mainly required in loan transactions involving large amounts, whereas creditors generally request debtor counsel to provide legal opinions on the corporate powers of the debtor entering the transaction; observations on financial covenants with other creditors; and opinions on legality and enforceability of the loan and respective collateral or guarantees. Legal opinions are especially relevant if the loan is granted to a distressed debtor, because according to the Brazilian Bankruptcy Law and in the event of bankruptcy of the debtor, certain acts are ineffective with regard to the bankruptcy estate, whether or not the lender was aware of the counterparty's economic and financial distress and whether or not the debtor intended to defraud creditors.[10]

10 (1) Payment by the counterparty within the bankruptcy legal term (up to 90 days as from the petition of bankruptcy) of debts not yet fallen due, by any means of extinguishment of the credit right, including by discount of the respective instrument; (2) payment made within the bankruptcy legal term of debts fallen due and enforceable, in any way other than as provided for in the respective contract; (3) creation of a security interest, including lien, within the bankruptcy legal term, in the case of a debt contracted previously; if the mortgaged assets are given in subsequent mortgage, the bankruptcy estate shall receive the portion otherwise applying to the creditor of the revoked mortgage; (4) acts performed free of charge during the two years preceding the decree of bankruptcy; (5) waiver of inheritance or legacy during the two years preceding the decree of bankruptcy; (6) sale or transfer of an establishment without the express consent of or payment to all creditors existing at the time, if the debtor has not kept sufficient assets to settle his liabilities, unless, within 30 days, there is no opposition by creditors after being duly notified by a court clerk or by an officer of the Registry of Deeds and Documents; and (7) registration of *in rem* guarantees and of property transfer, for a consideration or free of charge, or an annotation of real property made after the decree of bankruptcy, unless there is a previous annotation thereof.

iii Governing law and choice of jurisdiction

Governing law

In rem guarantees of assets located in Brazil must be governed by Brazilian law. Other agreements may be governed by foreign law in a contract if there is a connection between the foreign law chosen and the places where the agreement could be enforced or the place where the parties of such agreements are based. Nonetheless, discussions on the applicable law are not broadly, technically and deeply assessed before the Brazilian courts. In case of a litigation in Brazil involving an agreement governed by foreign law, Brazilian courts tend to disregard foreign law and apply Brazilian laws to the case. There is a different scenario if disputes are solved by arbitration, because arbitration law expressly allows parties to freely choose the governing law.

Foreign awards (judicial or arbitral) can be enforced in Brazil without re-examination of the merits of the case, provided such decision is:

a final and unappealable; and

b previously confirmed by the Superior Court of Justice (STJ).

Such confirmation generally takes from 6 to 18 months to be granted, and is available only if the decision fulfils certain formalities and if it does not violate Brazilian national sovereignty; public policy; and good morals and ethics. The STJ does not analyse the merits of the case to confirm a foreign award.

Choice of jurisdiction

Under Brazilian law, courts shall have jurisdiction (in addition to any other valid choice of jurisdiction that may have been made by virtue of contract) whenever:

a the defendant is domiciled in Brazil;

b the obligation has to be performed in Brazil; or

c the fact under dispute has taken place in Brazil.

Besides the above, Brazilian courts have exclusive jurisdiction in actions relating to real estate assets situated in Brazil. The parties may agree to submit disputes related to disposable rights to arbitration, but arbitration panels do not have the power to enforce a decision. The enforcement should be carried out by Brazilian courts.

VI LOAN TRADING

Loan transactions may be structured as bilateral loans or as syndicated loans. In both transactions, the agreement with the borrower is generally entered into only by one lender.

In syndicated loans, the lenders that provided the funding may freely trade their participation, providing notice to the syndicate leader. Such transactions impact neither the borrower nor the guarantors. Nevertheless, the substitution of the syndicate leader does impact such transactions.

The sale of the transaction by the single creditor in a bilateral loan or by the syndicate leader in a syndicated loan may be made by assignment of the loan agreement, endorsement of the loan agreement or novation of the loan, depending on the terms and

conditions of the original loan. In an assignment of loan, the lender should notify the borrower of the assignment. This should not affect *in rem* guarantees or aval guarantees, but may cause the release of personal guarantees, contract bonds and standby letters of credit depending on the wording of such documents. In an endorsement, all the guarantees set forth in the endorsed document should survive the transaction. On the other hand, novation causes the release of all guarantees.

VII OTHER ISSUES

i Enforcement

In Brazil, loan agreements can be judicially enforced if the debtor fails to comply with its loan obligations. The enforcement may be made through three different types of lawsuit, described below:

a summary or enforcement procedure, where the judge may immediately order payment of the debt and the foreclosure of collateral. Such lawsuit is available if:
- ascertainable through simple calculation, certain and undisputable; and
- the debt is represented by a document that qualifies as an extrajudicial enforcement instrument under Brazilian civil procedure rules;

b ordinary collection action, whereby the an order of payment of the debt and definitive foreclosure of assets can only be carried out after a final unappealable decision is rendered (which would take from 5 to 10 years to be issued, depending on the complexity of the underlying credit transaction); or

c monition action, which is similar to a summary procedure if the debtor does not file a defence, and which is similar to an ordinary collection action if the debtor files defence.

In view of those differences, loan transactions in Brazil are usually structured to allow the lender to file a summary or enforcement to collect the debt or foreclose collateral, avoiding time-consuming ordinary collection and monition actions.

ii Agreements using a foreign currency

Agreements and obligations enforceable in Brazil must state the amounts due in Brazilian currency. Parties may state amounts in foreign currency in certain cases, such as obligations involving foreign parties. Nonetheless, any judgment for payment of a certain debt in foreign currency obtained in Brazilian courts should be payable in Brazilian currency in an equivalent amount on the date of actual payment. In case of bankruptcy, all credits denominated in foreign currency shall be converted into local currency at the exchange rate prevailing in Brazil on the date of declaration of bankruptcy. In view of that, creditors must be aware that they hold exchange rate risk in case of bankruptcy.

iii Registration of foreign loans before the Brazilian authorities

Cross-border loan transactions with a tenor greater than 360 days must be registered before the Central Bank of Brazil registry of financial transactions module (ROF). Such registration allows the inflow and outflow of funds relating to the registered transactions and shall be obtained in the name of the parties to the transaction (i.e., the lender and

borrower). If the guaranteed transaction is registered before the ROF, the collateral or guarantee should also be registered to allow the guarantor to remit the funds abroad.

In addition to the ROF required by the Central Bank, the Federal Revenue Office requires that foreign entities carrying out transactions be subject to enrolment with National Register of Legal Entities. In order to obtain such enrolment, the foreign entity should also be registered with the Companies Register of the Central Bank through the Central Bank Data System.

iv Limitations to lending and secured finance

Brazilian financial institutions are not allowed to grant loans, advances or guarantees; enter into derivative transactions; underwrite; or hold in their investment portfolio securities of any clients or group of affiliated clients that, in aggregate, give rise to exposure to such client or group of affiliated clients that exceeds 25 per cent of their regulatory capital.[11]

Government and government-controlled corporations are subject to borrowing limits and cannot grant guarantees without proper authorisation.

VIII OUTLOOK AND CONCLUSIONS

Even though Brazil is suffering from recession and political turmoil in 2015, we believe those factors will adjust to a slow credit growth scenario by improving lending quality. However, a credit crunch is unlikely since the Brazilian financial sector is large, solid and sophisticated and Brazilian banks are less leveraged than foreign banks into recession in 2015.

On the other hand, such economic and political scenario may force congress and the government to take measures to enhance credit in the near future to foster growth.

11 For the purpose of such limit, the following public sector entities are to be considered as separate customers: (1) the Brazilian government; (2) an entity controlled directly or indirectly by the Brazilian government which is not financially dependent on another entity controlled directly or indirectly by the Brazilian government; (3) entities controlled directly or indirectly by the Brazilian government which are financially dependent among themselves; (4) a State or the Federal District, jointly with all entities directly or indirectly controlled by it; and (5) a municipal district, jointly with all entities directly or indirectly controlled by it.

Appendix 1

ABOUT THE AUTHORS

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Bruno Balduccini has been a partner since 2001 in the corporate area of the Pinheiro Neto Advogados office in São Paulo. His fields of expertise are banking regulations, business law, corporate law, financing, investments, M&A, exchange controls, credit cards, insurance and reinsurance. In addition to his practice in Pinheiro Neto Advogados, he is a Standing Member of the São Paulo Lawyers Institute since 2004, where he participates in the Banking Law Committee.

Mr Balduccini graduated with an LLB from the São Paulo Catholic University (1992), and holds a master's degree in International Banking Law from Boston University (1998). He was admitted to the Brazilian Bar Association in 1993.

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Roberto Panucci Filho is an associate in the corporate area of the Pinheiro Neto Advogados office in São Paulo. His fields of expertise are banking and insurance regulation, business law, corporate law, financing, investments, and foreign exchange controls. In addition, he also has a strong background in corporate and commercial litigation.

Mr Panucci earned a bachelors degree (LLB equivalent) from Universidade de São Paulo in 2008, a master's degree in contract law at Universidade de São Paulo in 2014 and an LLM at Columbia University in 2015.

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