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## RECENT HIGHLIGHTS IN BRAZILIAN BANKING LEGISLATION

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A recent decree-law<sup>1</sup> and pronouncements of the Central Bank and the Attorney General of the National Treasury have profound implications for practicing lawyers dealing with Brazilian banking transactions or the authority and status of Brazilian banks operating abroad. Decree-Law No. 1,928 of February 18, 1982 assumes that interest and principal of foreign currency loans contracted by public sector companies and governmental agencies will be paid on schedule. A recent opinion of the Office of the Attorney General of the National Treasury<sup>2</sup> concludes that set-off clauses in foreign currency loan agreements are illegal. In addition, the Central Bank has just issued regulations governing the opening and operation of foreign offices of Brazilian banks.<sup>3</sup> The purpose of this brief comment is to explain the major substantive points and possible effects of this legislation and administrative rulings.

### *Decree-Law No. 1,928*

It was reported in a number of newspaper articles during the first few months of 1982<sup>4</sup> that the Federal Government of Brazil, acting through Banco do Brasil S.A., had to step in and pay U.S. \$4,900,000,000 on foreign currency loan obligations of several public sector companies and governmental agencies. These payments were said to have been made by the Federal Government because certain public sector companies and governmental agencies were unable to make their scheduled repayments because they had al-

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1. Article 55 of the Federal Constitution authorizes the President of the Republic, in cases of urgency and significant public interest, and provided that there is no increase in expense, to promulgate decree-laws dealing with public finance and taxes.

2. Opinion of Mar. 10, 1982, D.O. Mar. 17, 1982, at p. 4627.

3. Central Bank Resolution No. 728 of Mar. 24, 1982 and Central Bank Circular No. 685 of Mar. 30, 1982.

4. Jornal do Brasil of Mar. 21, 1982 and Apr. 2, 1982.

ready spent the funds budgeted for such loan repayments. To avoid tarnishing its excellent credit reputation within the international banking community, the Brazilian government authorized Banco do Brasil S.A. to advance the necessary funds in behalf of the soon-to-be defaulting borrowers.

Decree-Law No. 1,928 contains four important provisions. One, it establishes the absolute priority of payment, within the budgets of public sector companies and governmental agencies, of all foreign currency loan obligations, regardless of whether such loans are guaranteed by the National Treasury. Two, it makes the administrators of public sector companies and governmental agencies jointly and personally liable for any delays in the repayment of foreign currency loan obligations of their respective companies or agencies. Three, it authorizes the Brazilian Central Bank to block or freeze all bank accounts of public sector companies or governmental agencies in order to insure the timely repayment of all their foreign currency loan obligations. Four, it establishes procedures for reporting and judicially expediting all violations of this Decree-Law, including the sanction of immediate dismissal of all responsible administrators.

Decree-Law No. 1,928 is a message to the international banking community that the Brazilian Government will not tolerate any default of foreign currency loan obligations contracted by public sector companies and governmental agencies, by far the greatest number of borrowers of foreign loans in Brazil. It is also a stern warning to all officers and directors of public sector companies and officials in governmental agencies that they must promptly repay their foreign currency loan obligations, regardless of their cash-flow situation or unbudgeted extraordinary disbursements. Many Brazilian lawyers and legal commentators consider Decree-Law No. 1,928 a type of "comfort letter" designed to reassure foreign lenders that the Brazilian government fully intends to honor all its foreign loan commitments, even those which do not have the guarantee of the National Treasury.

#### *Attorney General's Opinion on Bank Setoffs*

Most international loan agreements contain a clause permitting the bank or creditor to set-off and counterclaim in the event of default by the borrower. The following language is typical:

The Borrower expressly consents and agrees that any Bank or

holder of a Note may exercise any and all rights of banker's lien, set-off and counterclaim with respect to any and all monies owing by the Borrower to such Bank or holder.

Such a clause, as well as normal banking practices, enables the lending bank to "set off" all amounts which such Borrower may have on deposit with or credited to it against any amounts due and owing by the Borrower under a loan agreement.

A March 10, 1982 Opinion of the Office of the Attorney General of the National Treasury ("Opinion") holds that such set-off clauses are illegal and unenforceable as a means of satisfying debts incurred under foreign currency loan agreements. The Office of the Attorney General of the National Treasury based its Opinion on two separate rationales:

a. Law No. 4,131 of September 3, 1962 authorized the Brazilian Central Bank to regulate all foreign remittances, including principal and interest payments on foreign loans, amortizations, commissions and income taxes. Law No. 4,595 of December 31, 1964 established strict exchange controls and authorized the National Monetary Council and the Brazilian Central Bank to supervise all such controls.

Based on the foregoing legislation, the Office of the Attorney General of the National Treasury has concluded that set-off clauses in foreign currency loan agreements materially prejudice and hamper the ability of the Brazilian Central Bank to administer and supervise foreign remittances and exchange controls, and are thus illegal and unenforceable in Brazil.

b. Decree No. 23,258 of January 19, 1933 and Decree-Law No. 9,025 of February 27, 1946 prohibit certain foreign currency exchange operations and private bank clearings, respectively. The Office of the Attorney General of the National Treasury argues and holds that the set-off procedure under a foreign loan agreement is similar to an illegitimate foreign exchange operation or private bank clearing, as described and prohibited by the aforesaid Decree No. 23,258 and Decree-Law No. 9,025, respectively, and is thus illegal and unenforceable in Brazil.

The Opinion is not unexpected and will not greatly alter current banking practice in Brazil, since public sector borrowers and the Office of the Attorney General have for some time objected to the inclusion of set-off clauses in foreign currency loan agreements containing the guarantee of the federal government. Furthermore, because of the excellent performance record of most Brazilian borrowers (and the watchful eye of the Brazilian Central Bank), there

have been few, if any, recent occasions for use of a set-off clause because of default by a Brazilian borrower. The Opinion clarifies the legal basis for Brazilian borrowers and guarantors objecting to the inclusion of set-off clauses in international loan documents. In the final analysis, however, this legal argument may have little practical significance because most international loan agreements entered into by Brazilian borrowers and guarantors stipulate that they are governed by the laws of New York or England, both of which permit, in practice, set-offs as a means of satisfying debts due and owing under loan agreements.

*Brazilian Central Bank Resolution No. 728 and Circular No. 685.*

According to newspaper reports,<sup>5</sup> Brazilian banks have opened more than 100 offices outside Brazil. Fifty-one of these offices have been opened during the past three years. An unofficial estimate of the number of Brazilian banks with New York offices is eighteen; four Brazilian banks have opened offices in Miami, Florida. The foreign offices of Brazilian banks, including agencies, branches and representative offices, are now starting to play a significant role in capturing foreign funds for foreign currency loans to private and public companies in Brazil.

In an effort to regulate and control the activities of these foreign banking offices, and thus the effect that such foreign banking operations have on the national economy, the Brazilian Central Bank recently passed regulations governing the opening and operating of branches, agencies and representative offices of Brazilian banks abroad. Such regulations also govern any participation by Brazilian commercial and investment banks in the capital of foreign banks. All such activities require the prior authorization of the National Monetary Council. Application for such authorization must include all personal information on its proposed representative abroad, a certified copy of the Board of Directors Resolution approving the foreign activity and the reasons for such decision, the types of activities that will be undertaken by the bank outside Brazil, and a detailed report regarding the performance of any other foreign offices of the bank.

The National Monetary Council will only approve applications that meet the following requirements:

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5. *Jornal do Brasil*, Mar. 15, 1982.

1. The paid-in capital of the parent bank in Brazil cannot be less than 2.14 billion cruzeiros (approximately \$ U. S. 14.3 million at the exchange rate prevailing on April 6, 1982).
2. The amount of capital allocated to the foreign office cannot exceed 25% of the capital of the parent bank in Brazil, and must be accompanied by a paid-in capital increase of the parent bank, unless the capital of the foreign office will be derived from funds generated abroad.
3. Brazilian banks either opening an office abroad or participating in the capital of a foreign bank must hold at least 51% of the capital of such foreign bank.
4. If a banking group in Brazil desires to open a foreign office or participate in the capital of a foreign bank, only the commercial bank of such group will be permitted to be the principal or stockholder of such foreign banking entity.
5. Foreign offices will only be permitted for commercial banks that already have agencies abroad or where the actual establishment of offices is a pre-condition for opening a banking agency in the chosen country.
6. The expenses of establishing and maintaining offices abroad can only be paid for with funds generated by the commercial bank outside Brazil, except in the case of Brazilian parent banks that do not have foreign offices operating for more than three years.
7. In the event that the foreign country imposes no limitations on the borrowing of sight or term deposits or the issuance of guarantees, the foreign office must comply with the respective borrowing limits and pertinent rules applicable to the parent bank in Brazil.
8. All parent banks with foreign offices must have a management department at the level of its Board of Directors responsible for its international operations, as well as appropriate auditing procedures relating thereto.

These regulations by the Brazilian Central Bank are the first step towards regulating an area which, for all practical purposes, had been unregulated and is rapidly becoming a significant factor in the planning of Brazil's economy.

The legal matters described above will no doubt be supplemented and modified with great frequency. It is imperative that counsel be familiar with these legislative and administrative changes and stay abreast of all developments in this area.