NETTING OF OTC FINANCIAL CONTRACTS IN LATIN AMERICA AND THE CARIBBEAN

LEGAL BASIS IN BRAZIL FOR THE NETTING OF FINANCIAL CONTRACTS

FERNANDO RUIZ DE ALMEIDA PRADO

Sponsors

The Federal Reserve Bank of New York
The World Bank
The Centre for Latin American Monetary Studies (CEMLA)
Mexico City, November 9, 2000

SUMMARY

• Introduction

• Regulations on swap transactions in Brazil

• Netting in Brazil

• Bankruptcy Law

• Validity of Early Termination Clauses in Brazil

• Conclusion
INTRODUCTION

- Benefits of Netting x doubts and uncertainties as to the efficacy of clauses of early termination upon an insolvency event.

- Common concern of swap dealers when dealing with Brazilian counterparties.

- Trustee’s ability to “cherry pick”.
SWAP REGULATIONS IN BRAZIL

- **1992/1993** → Central Bank’s regulations allowing Brazilian companies to carry out swap transactions with institutions overseas (Resolutions 1921, 2012 and Circular 2348).

- **1994** → Central Bank’s regulations authorizing local financial institutions to carry out swap transactions in the local OTC market.

- None of such regulations address “netting”.

Mexico City, November 9, 2000
Mexico City, November 9, 2000

NETTING IN BRAZIL

• The Brazilian Civil Code (Law No. 3071 of January 1, 1916).

• “Art. 1009. If two persons are creditor and debtor to each other at the same time, the two obligations are discharged to the extent of their offsetting”.

• “Art. 1009. Se duas pessoas forem ao mesmo tempo credor e devedor uma da outra, as duas obrigações extinguem-se, até onde se compensarem”.

Copyright © 2000 by Pinheiro Neto - Advogados. All rights reserved.
BASIC REQUIREMENTS FOR NETTING IN BRAZIL

- Obligations must be of a certain amount.
- Obligations must be matured.
- Obligations must be of the same nature.
Mexico City, November 9, 2000

BANKRUPTCY LAW

- Article 43 of the Decree-Law No. 7661 of June 21, 1945 (the “Brazilian Bankruptcy Law”) establishes that bilateral agreements are not terminated by the declaration of bankruptcy, and may be fulfilled in the event the Síndico (trustee of the bankrupt estate) should deem this to be in the interest of the estate.

- Article 46 states that the debts of the bankrupt estate maturing on or before the date of bankruptcy, either as per the bankruptcy declaration itself or upon expiry of the stipulated term, shall be eligible for offsetting.”
What should prevail? 
- The validity of such clauses is generally accepted by jurists
- The Síndico freedom should not be unlimited
- Upon early termination, at least one of the requirements for netting will exist.
Netting is recognized in Brazil as a legal method of liquidation of obligations.

- Civil Code.
- Bankruptcy Law.
- New legislation on clearing systems.

The Síndico ability to “cherry pick” should not be unlimited.

Early termination clauses must be respected by the Síndico.

New laws would of course eliminate doubts and uncertainties still existing.