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Fiduciary collateral in favor of foreign financial institution

Fifteen years after the current Brazilian Civil Code was enacted doubts remain regarding the fiduciary property mechanism.

A fiduciary transfer is a special transfer of ownership as guarantee of debt. As a rule, the debtor maintains possession, which the fiduciary creditor only takes in case of default. In this case, the creditor must sell the asset and apply the proceeds towards satisfaction of its credit and collection expenses, returning the balance, if any, to the debtor.

The fiduciary transfer was first introduced in the Brazilian legal framework by Law No. 4,728, dated July 14, 1965. Because that law regulates Brazilian financial and capital markets, case law reached the understanding that the fiduciary transfer could be entered only where the creditor was a Brazilian licensed financial institution. In 2002, the Brazilian Civil Code introduced the fiduciary property, a new mechanism that is equivalent to the fiduciary transfer of non-fungible assets, but can be used to benefit any creditor, thus eliminating the restrictions from Law No. 4,728/65.

In a recent decision, the Second Court of Bankruptcy and Judicial Restructuring of São Paulo has decided that foreign financial institutions that are not authorized to operate in Brazil cannot hold the status of fiduciary creditors[1]. Accordingly, the judge determined that the claims of such financial institutions shall be subject to the debtor's bankruptcy as unsecured or secured credits (*créditos quirografários ou com garantia real*), as the case may be.

As stated in the recent judgement, there would be two different legal systems regulating the fiduciary property of movable assets: (i) the one provided by the Civil Code, applicable when the fiduciary creditor is an individual or a legal entity; and (ii) the one established by Law 4,728/65, applicable when the fiduciary creditor is a locally licensed financial institution. Foreign financial institutions would be excluded from the first system as they are financial institutions, but also from the second one, since they are not part of the Brazilian Financial System.

However, foreign financial institutions may hold the status of fiduciary creditors under the Civil Code, assuming, obviously, that the instrument of security provides for the regime of Articles 1,361 and following of the civil law. After all, foreign financial institutions are legal entities and there are no rules prohibiting them from being fiduciary creditors. Under the Brazilian Constitution, only the law can impose obligations or prohibitions.

One of the consequences of applying the fiduciary regime of the Civil Code is that, contrarily to Law No. 4,728/65, the Civil Code does not allow the fiduciary property over fungible assets. However, such restriction can be circumvented in most cases, since the fungibility is not an objective characteristic of the assets, but rather a subjective approach of the individual describing them. Thus, it is possible to make assets non-fungible by identifying them in a distinctive way. For example, shares can be described by their serial number or other particular characteristics and credits can be specified as arising from deposits made in a certain bank account.

Preventing the creation of fiduciary collateral in favor of foreign financial institutions would be against Brazilian Constitution and would constrain international credit to Brazilian entities.

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[1]Credit Contestation - Classification of credits in the action No. 0015946-47.2016.8.26.0100. Judge Paulo Furtado de Oliveira Filho. Judged on February 7, 2017.