Investment rules
of the world
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About

At DLA Piper, we have one of the largest finance and projects teams in the world with more than 600 dedicated lawyers and an established local law firm network. We share knowledge and skills in debt instruments, debt securities, funds, derivatives and portfolios, as well as energy, infrastructure and other projects, across Europe, the Middle East, Africa, Asia Pacific and the Americas.

When and wherever we work for you on finance and investment deals and projects, you can rely on our international platform; we are backed by the network and resources of one the largest and most-connected business law firms in the world.

We enjoy being part of your team, bringing experience across sectors, borders and financial products, supporting you on first-of-a-kind deals, in new markets and to grow.

With global perspective, we can help you to realize your financial strategy in whichever markets you do business.

Investment Rules of the World

With input from across our global network, this guide covers key legal topics for different financial activities and projects and gives you an overview of the points you may consider when initially looking at financing or investing in particular jurisdictions. Please contact us if you would like to discuss any legal issues or solutions for your business. We also welcome your feedback about this guide via investmentrules@dlapiper.com.
Angola

Last modified 23 July 2020

Capital markets and structured investments

Issuing and investing in debt securities

*Are there any restrictions on issuing debt securities?*

No.

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*What are common issuing methods and types of debt securities?*

The most common type of debt securities in Angola is the issuance of commercial paper. Commercial paper is debt securities with a maturity of one year or less. Commercial companies, public companies, civil companies in commercial form and other legal persons governed by public or private law may issue commercial paper.

Among other requirements, the issue of commercial paper requires prior legal certification of accounts or auditing by an auditor registered with the Capital Market Commission (CMC).

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*What are the differences between offering debt securities to institutional / professional or other investors?*

- Agreements for investment services concluded with non-institutional investors shall be in writing and only such investors may invoke invalidity resulting from failure to comply with the form.
- In intermediation agreements signed with non-institutional investors for the execution of operations in Angola, the possible application of foreign law may not have the consequence of depriving the investor of the protection ensured by the Angolan Securities Code provisions on information, conflict of interest and asset segregation.
- Brokers must establish, in writing, an internal policy that allows them, always, to know the nature of each client, as a non-institutional or institutional investor, and to adopt the necessary procedures for its implementation.
- The Broker’s information duties to non-institutional investors are far more extensive than to institutional investors.

Assessment of the Adequate Character of the Operation:

In the case of non-institutional investors, the broker must ask the client for information regarding their knowledge and investment experience with regard to the type of security and derivative instrument or the service considered, to enable them to assess whether the client understands the risks involved.
If the broker considers that the transaction under consideration is not suitable for that client, they should advise the client in writing.

In the case of institutional investors, the broker may assume that, in respect of securities and derivatives, operations and investment services, the client has the necessary level of experience and knowledge to assess the appropriateness of the operation.

- Public Offers:

An offer addressed to at least 150 people who are non-institutional investors resident or established in Angola is qualified as public.

**When is it necessary to prepare a prospectus?**

The general rule is that any public offer of securities must be preceded by the disclosure of a prospectus.

The exceptions to this rule are:

- public offers of securities to be awarded, on the occasion of a merger, to at least 150 shareholders other than institutional investors, provided that a document containing information considered by the CMC to be equivalent to that of a prospectus is available at least 15 days before the date of the General Meeting;

- the payment of dividends in the form of shares of the same class as the shares in respect of which the dividends are paid, provided that a document is available containing information on the number and nature of the shares and the reasons for and details of the offer;

- public offers for distribution of securities to existing or former directors or employees by their employer where the employer has securities admitted to trading on a regulated market or by a company controlled by it, provided that a document is available containing information on the number and nature of the securities and the reasons for and details of the offer; and

- public offers for sale of securities admitted to trading on a regulated market, provided that the admission prospectus is up to date.

**What are the main exchanges available?**

BODIVA – Angolan Debt and Stock Exchange

**Is there a private placement market?**

No.

**Are there any other notable risks or issues around issuing or investing in debt securities?**

No.

**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**
What are common fund structures?

Securities investment funds
Real Estate investment funds
Venture Capital investment funds

What are the differences between offering fund securities to professional / institutional or other investors?

Investment funds may be set up exclusively for institutional investors. In that case the Fund rules shall be explicit about the exclusive participation of institutional investors. A Fund intended exclusively for institutional investors may establish different rules compared to other funds, in particular establishing different time limits for ascertaining the value of the unit and payment of redemption, charge a management fee on the basis of the results of the Fund or dispense with the preparation of a half-yearly report.

Are there any other notable risks or issues around establishing and investing in funds?

No.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

The establishment of an investment fund is subject to prior authorization by the CMC.

Authorization requires approval by the CMC of the incorporation documents, the choice of depositary and the management entity's request to manage the Fund.

Are there any restrictions on managing a fund?

The management of Investment Funds may only be exercised by fund management entities empowered by law and registered with the CMC.

Fund management entities must maintain their business organization equipped with the human, material and technical resources necessary to provide their services under appropriate conditions of quality, professionalism and efficiency, in order to avoid wrong procedures.

Real Estate Fund Management entities must also maintain a technical department qualified to provide real estate project analysis and monitoring services or to contract such services externally.
Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

No.

What are common types of derivatives?

- Swaps
- Options
- Futures

Are there any other notable risks or issues around entering into derivatives contracts?

No.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

The development of professional lending activity may only be carried out by financial institutions authorized by the BNA.

Foreign investors who develop their projects by using benefits under the Private Investment Law may have recourse to credit in Angolan banks (under the Angolan applicable legislation).

What are common lending structures?

The common lending structures are Financial Banking institutions.

What are the differences between lending to institutional / professional or other borrowers?

The law does not mention special differences between lending to institutional and non-institutional debtors.

The only legal regime that is exclusive to individuals is the consumer credit regime.

Do the laws recognize the principles of agency and trusts?
Are there any other notable risks or issues around lending?
No.

Are there any other notable risks or issues around borrowing?
No.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?
A company can grant a security interest aiming to secure its obligations as a borrower on a credit facility and as a guarantor of the obligations of other borrowers and guarantors' obligations under a credit facility.

For that reason, the general rule set forth under Angolan legal framework is that a company's corporate power is restricted to rights and duties considered adequate in order to proceed with the exercise of the company's corporate object.

Hence, it is assumed that the granting of guarantees regarding other entities' duties is opposed to the purpose of companies, except in situations where the companies' own interest is legitimate in providing the guarantee or the company being considered is in a group or control relationship with other companies (Article 6(3) Angolan Companies Law).

The company's own legitimate interest is visible when providing the downstream guarantees. However, it is less visible when providing upstream and cross-stream guarantees, being advisable for the necessary resolutions to be given with the intention to justify the own interest of the company, which in certain circumstances might be an indirect one, when providing the guarantee.

In regard to governmental or other consents or filings (or other formalities) required when granting/taking a guarantee, with exception of when there are state-owned and other public sector companies, the general rule is that no governmental consent or filings is required under the law, in order for a guarantee being provided by an Angolan company to be enforceable.

Notwithstanding, a guarantee provided by an Angolan company becomes enforceable when either a shareholder or border consent is given in accordance with the Angolan Companies Law. Commonly, such consent will detail expressly the benefit expected to be acquired from the provision of the guarantee.

Moreover, a security can be taken over inventory when executing a written agreement. Whenever there is a situation of non-payment or the occurrence of other circumstances presumed to be described in the pledge agreement, the pledger or security agent can provide an enforcement notice to the pledgor. As an alternative, parties may prefer the provision of ordinary notices containing details of the stock.

Additionally, a company cannot guarantee and/or give a security to support borrowing arising from the financing of direct or indirect acquisition of shares of the company, being expressly forbidden (Article 344 of the Angolan Companies Law). Exceptions are available. Criminal liability of the directors/managers of such company may be considered when violating this prohibition, as well as the declaration of voidance and nullity of the agreement, guarantee or security interest.

Contrary to that, no express prohibition exists when the subject is the direct or indirect financing of shares of any company which directly or indirectly owns shares in the company or shares in a sister subsidiary, even though it is generally understood as applicable. Again, as previously mentioned, the corporate powers of the company may be restricted in respect of granting of guarantees or security.
What are common types of guarantees and security?

The Angolan Civil Code in Book II, Chapter VI, establishes the following types of secure lending obligations:

I. Provision of Bonds;

II. Bail;

III. Consignation of income;

IV. Pledge;

V. Mortgage, and

VI. Right of Retention.

Angolan law establishes that the possibility to provide general security over the assets of a given entity through a general security agreement is treated as null and void since there is a lack of determination of the specific assets subject to the security.

Thus, a security agreement must identify the assets that are subject to the security created by the agreement. It must have a certain criterion that as a result gives the possibility to identify the secured assets at a given time.

As mortgages and consignation of income must be granted by public deed, whereas pledged may be granted by the celebration of private agreements, the adoption of one single agreement or separate agreements varies in accordance with the type of security being granted.

Moreover, in companies incorporated in Angola, security can be taken over shares by pledges of shares (quotas or shares).

The shares on a Joint Stock limited liability companies (Sociedades Anónimas) are carried out through means of registration in the securities holder’s account, with an indication of the number of shares pledged, the guaranteed obligation and identification of the beneficiary. If the voting right is granted to the pledge creditor, the pledge may be constituted by registration in their account. In the other hand, on Private limited liability companies (Sociedades por Quotas), the pledge must be done through means of a public deed.

The said pledges of shares may be either in book-entry form or in a certified form. The procedure to be followed varies according to the type of company in question, since such security can be granted by a document governed by the laws of other jurisdiction (e.g. English law) upon the compliance of the formalities set out by Angolan Law.

Are there any other notable risks or issues around giving and taking guarantees and security?

In circumstances where only a small benefit to the guaranteeing/securing company can be shown, it is likely that there is no legitimate interest to the company in providing the guarantee/security.

Consequently, unless the company is part of a group or it is in a control relationship with the entity whose obligations it guarantees/secures, the granting of the guarantee/security may be declared null and void.

The Civil Procedure Code, article 1175, determines that the declaration of bankruptcy may be filed within two years of the occurrence of the facts established by law, even if the trader has ceased trading or died.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in
**finance and investments generally?**

**Banking**

Law of the National Bank (Law nº 16/10, from July 15)
Financial Institutions Law (Law nº 12/15, from June 17)
Law to Prevent and Combat Money Laundering and the Financing of Terrorism and the proliferation of weapons of mass destruction (Law nº 5/20, from January 27)
Foreign Exchange Regime Law (Law nº 5/97, from June 27)

**Securities**

Securities Code (Law nº 22/15, from August 31)
Legal Framework of Investment Funds (Presidential Legislative Decree No. 7/13, from October 11)
Legal Framework for Venture Capital Collective Investment Schemes (Presidential Legislative Decree 4/15, from September 16)

**Regulatory authorization**

**Who are the regulators?**

- Central Bank (*Banco Nacional de Angola* (BNA));
- Capital Market Commission (*Comissão de Mercado de Capitais* (CMC)).

**What are the authorization requirements and process?**

The incorporation of financial banking institutions is subject to authorization by the Central Bank (BNA).

In general, in order to obtain authorization from the regulator, financial banking institutions based in Angola must:

- have as their exclusive object the exercise of the activity legally permitted, under the terms of Article 6 of this Basic Law of Financial Institutions;
- adopt the form of a public limited company;
- have share capital not less than the legal minimum;
- have share capital represented by registered shares;
- have sound corporate governance arrangements, including a clear organizational structure with well-defined, transparent and consistent lines of responsibility;
- have effective processes to identify, manage, control and communicate the risks to which is or might be exposed;
- have appropriate internal control mechanisms, including robust administrative and accounting procedures; and
- have remuneration policies and practices that promote and are consistent with sound and prudent risk management.

**What are the main ongoing compliance requirements?**

Financial institutions must comply with the requirements set out in Law 5/20, of January 27 – Law to Prevent and Combat Money Laundering, Financing Terrorism and Proliferation of Weapons of Mass Destruction.
Qualified holdings: the banking financial institution over which a natural or legal person, directly or indirectly, intends to hold a qualified holding must first formulate an authorization request to the Central Bank (BNA). A holding in a company, directly or indirectly, of not less than 10% of the capital or voting rights of the company in which a participation is held or which, for any reason, makes it possible to exercise a significant influence over the management of the institution in which the participation is held, shall be deemed to be qualified.

What are the penalties for failure to be authorized?

The unauthorized practice of transactions reserved for financial institutions, as well as the exercise by a financial institution of activity not included in its legal object, and the carrying out of unauthorized operations or operations which are specially prohibited to them, is punishable by a fine of AOA300,000 to AOA150 million and from AOA500,000 to AOA500 million, depending on whether an individual or legal person is involved.

In addition to fines, ancillary sanctions, such as seizure and confiscation of the object of the offence, including the economic proceeds thereof, may be imposed on the offender.

Regulated activities

What finance and investment activities require authorization?

The financial activities carried out by the following entities require the authorization of the Capital Market Commission (CMC):

- securities brokerage firms;
- securities distribution companies;
- investment companies;
- asset management companies;
- securities and real estate investment fund management companies;
- venture capital companies;
- venture capital fund management companies;
- brokers, investment advisors and independent financial analysts.

In particular, the following investment services and activities in securities and derivatives require authorization:

- the reception and transmission of orders on behalf of others;
- the execution of orders on behalf of others;
- portfolio management for third parties;
- investment advice, including the preparation of studies, financial analysis and other general recommendations;
- underwriting and placement with or without a guarantee in a public offer for distribution;
- assistance in connection with public offerings of securities;
- registration and deposit of securities and derivative securities and services related to their safekeeping, such as cash or guarantee management;
- the granting of credit, including the lending of securities, intended exclusively for the purpose of carrying out transactions in securities and derivative instruments involving the grantor of credit; and
Are there any possible exemptions?

As a rule, only brokers may engage in securities and derivatives investment services and activities in a professional capacity. However, the following are excluded from this rule:

- the Central Bank (BNA), the State and other public entities within the scope of the management of public debt and State reserves;
- people who provide investment services exclusively to its dominant company, its subsidiary, or to its own subsidiary;
- people who provide investment advice as a normal, non-specifically remunerated supplement to the provision of investment services;
- people whose only investment activity is dealing on own account, provided they are not market makers or entities dealing on own account outside a regulated market in an organized, frequent and systematic manner, providing a system accessible to third parties for the purpose of dealing with them.

Do any exchange controls or other restrictions on payments apply?

The Foreign Exchange Law regulates the acts and commercial and financial transactions which have or may have an actual or potential impact on its balance of payments. The implementation of the provisions of this law and of the respective complementary or regulatory diplomas shall be subject to the provisions of this law:

- exchange transactions;
- exchange trading.

According to this legislation, certain foreign exchange transactions are subject to restrictions, such as the need to obtain authorization from the Central Bank (BNA), the limit on the transfer of values. Given the size of foreign exchange transactions, the restrictions must be analyzed on a case-by-case basis. Nevertheless, the most recent legislation has been drafted with a view to making these same operations simpler and more expeditious.

Foreign exchange transactions may only be carried out through a financial institution authorized to engage in foreign exchange trading. Foreign exchange operations are considered, according to the law:

- the acquisition or disposal of gold in cash, in bar or in any unworked form;
- the acquisition or disposal of foreign currency;
- the opening and movement in the country by residents or non-residents of foreign currency accounts;
- the opening and operation in the country, by non-residents, of accounts in national currency; and
- the settlement of any transactions of goods, current invisibles or capital.

What are the rules around financial promotions?

Information disclosed in Angola which may influence investors' decisions, namely when it relates to public offers, regulated markets, services and activities of investment in securities and derivatives and issuers, must be written in Portuguese or accompanied by a legalized translation into Portuguese.

Information concerning securities and derivatives, issuers, public offers, regulated markets and their infrastructures, investment services
and activities in securities and derivatives must be complete, true, timely, clear, objective and lawful.

Contracts for investment services concluded with non-institutional investors shall be in writing and only such investors may invoke invalidity resulting from failure to comply with the form.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

The legal entities generally used to undertake financial or investment activity are investment funds.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes, it is possible to conduct lending or investment business through a branch of a financial institution.

Foreign-based financial institutions wishing to carry out activities in Angola through the establishment of branches are subject to the authorization of the President of the Republic, subject to the prior opinion of the BNA.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

- Fintech for payments services
- Fintech for banking services

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

There are no specific laws applicable to fintech products. General legislation, such as the consumer protection act or the personal data protection law, among others, are applicable to said products.

What type of funding arrangements and incentives are available to FinTech businesses?

The BNA has a program called LISPA, which is an innovation laboratory for the payment system.

The goal is to accelerate the development of fintechs and innovative projects that promote access to financial services. LISPA is the only program that we consider an incentive to fintech businesses.
Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

The most common way to buy and sell loans is through the assignment of credit and the assumption of debt. These operations are regulated and provided for in the Angolan civil code.

What are the main considerations when transferring a loan and related security?

- Make sure that the initial agreement does not prohibit any form of transmission.
- The effectiveness of the assignment is dependent on notification to the debtor.
- Obey the legal form of the business that serves as the basis.
- The assignment of mortgage credits when not made in a will and the mortgage falls on real estate to be made by public deed.

The credit that is the subject of assignment must comply with the following requirements:

- it must have a pecuniary nature;
- it must be unconditional;
- it cannot be litigious; and
- it cannot have been given as a guarantee or collateral.

The assignment of credits, since it is subject to the general regime of legal business, may be the object of the means of preserving the equity guarantee provided for in arts. 605 and following of the Civil Code. Consequently, it can be contested by the creditor of the assignor, in the exercise of their right of action.

In addition, the requirements and effects of the assignment between the parties are defined according to the type of business on which it is based.

The assignment may not occur when it is prohibited by law or agreement of the parties and the claim is, by the very nature of the benefit, linked to the person of the creditor.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

The main assets of the sector in terms of production, transport and distribution have been acquired through public investment. Although public investment has advantages in terms of less complexity associated with works contracts and lower financial costs associated with concessional loans, in many cases, the participation of the private sector allows greater efficiency in investment decisions, risk mitigation and operation, which also constitutes an additional source of financing for the sector.
For the future, public investment should be reduced and reserved for activities and infrastructures that are in charge of the public sector or that benefit rural electrification, namely:

- large dams that due to their size cannot be made via private financing;
- Very High Voltage Transport – an activity that guarantees national energy security;
- investments in the distribution of areas that are the responsibility of the public utility company for the distribution of electricity; and
- investments in rural electrification, including transport and distribution infrastructures for isolated systems, which will later be managed by the private sector responsible for construction.

The participation of the private sector should cover an investment of USD8.9 billion, essentially at the level of Urban Production and Distribution.

Are there special rules for investing in energy and infrastructure?

There are general rules provided for in the Private Investment Law, approved by Law 10/18 of June 26, which are applicable to investment in the energy and infrastructure sector. Rules such as access to tax, exchange, customs and other benefits. Or also the forms of investment.

In addition to these rules, there are special rules for these sectors, of which we highlight the following:

The electricity sector has its main legislative and regulatory source in the Law no. 14-A / 96, of May 31 (General Electricity Law), which establishes the general guidelines the legal regime for the exercise of production, transportation, distribution and use of electrical energy, and has many other relevant diplomas, aimed to regulate its supply; distribution; production and transport chain, as also its commercial relations, including the quality of services, tariff regulation and access to networks and interconnections.

The exercise of electricity production, distribution and transport activities requires authorization from the state or a public legal person, by means of a concession or license.

The construction and operation of the electrical installations associated with the activities of production, distribution and transport of electricity also requires licensing, under the terms of the Installation Licensing Regulation. The competence for licensing these facilities is, as a general rule, the Ministry that supervises energy (Ministry of Energy and Water).

The regulation of the Angolan electrical system determines that the commercialization of electrical energy can be made within the scope of the Public Electrical System (SEP) (e.g. linked) or outside it (i.e. not linked).

What is the applicable procurement process?

According to the law, the approval of concessions as well as their attribution are the responsibility of the President of the Republic. The award of concessions is preceded by a public tender or restricted tender by prior qualification, carried out in accordance with the Public Procurement Law.

In the case of award to a public company or to a company under the effective control of the state, the above tender process is dispensed.

The attribution of licenses is the responsibility of the government, and this responsibility may be delegated to the local administration bodies of the state in its area of jurisdiction, the object of the licenses is concerned with the distribution and sale of electricity under a public service regime.

What are the most common forms of funding / investing in energy and infrastructure?

Public companies or companies with public domain of the state, if the investor is a public entity.
Or, for a private investor, the most common types of business structures considered by foreign companies to operate in Angola are:

- branches, which, although allowing the undertaking of commercial activities in Angola, are not independent legal entities, and thus the foreign parent entity undertakes unlimited liability for the obligations of the branch, and arising out from the performance of its activity in Angola; or
- representative offices, which are merely aimed at developing and following the business of the foreign entity in Angola but are expressly forbidden to conduct any commercial activity in the country; or
- companies (subsidiaries), which in Angola include (i) Private limited liability companies (Sociedades por Quotas), and (ii) Joint Stock limited liability companies (Sociedades Anónimas).

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

Regulatory investigations can occur in the following situations:

By the BNA:

- In carrying out its supervisory functions, it is the responsibility of the supervisory body to monitor the activity of financial institutions under its responsibility supervision and promote risk assessment and control, as well as the sufficiency of own funds to support these risks.
- When customers submit complaints based on non-compliance with rules governing the activity.
- In case of suspicion of the laws mentioned in topic I.
- In case of violation of the laws mentioned in topic I.

Additionally, the CMC continuously monitors the entities subject to its supervision. The CMC can carry out regulatory investigations:

- when investor protection is at stake;
- to prevent systemic risk; and
- to prevent and reprimand of actions contrary to the law or regulation.

What regulatory penalties may apply?

For committing infringements/infractions, the regulatory penalties to be applied consist of warnings, fines and fines for particularly serious infringements. For example:

- AOA50 million and AOA150,000 to AOA150 million, depending on whether it is applied to a natural or legal person.
- AOA300,000 to AOA150 million and AOA500,000 to AOA500 million, depending on whether the natural or legal person is applied.

Some examples of infractions are: the exercise of the activity in disregard of the rules on registration with the supervisory body; the violation of the rules on subscription or payment of the capital stock, as to the term, amount and form of representation; the omission of information and communications due to the respective supervisory body, within the time limits established and the provision of information incomplete.

In addition to the above-mentioned fines, ancillary sanctions may be imposed on the offender, such as: seizure and confiscation of the object of the offence, including its economic product; disqualification from exercising corporate positions and management functions in
financial institutions, for a period of six months to three years, in certain cases provided for by law or three months to one year, in others, also provided for by law.

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**What criminal penalties may apply?**

The court is not bound by the assessment of the fact as a misdemeanor and may, *ex officio* or at the request of the Public Prosecutor’s Office, convert the case into a criminal case.

If such a situation occurs, the court should apply the regime established in the Criminal Code and complementary legislation to the crime in question. This may vary from case to case and punishments may include prison sentences and criminal fines.

However, there are certain criminal offences for which the law already provides for the criminal institute to apply, such as the illegal activity of receiving deposits and other repayable funds, for which the law provides that those who carry out activities consisting of receiving deposits or other repayable funds from the public, on their own account or on behalf of others, without the necessary authorization, shall be punished by imprisonment of up to five years.

Notwithstanding this provision, the regime established in the Criminal Code and complementary legislation shall always apply.

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**Tax**

**Tax issues**

*Are stamp, registration, transfer or other similar taxes applicable?*

Yes. Stamp and registration taxes are applicable. Regarding the transfer taxes, they are also applicable, and the value added tax (VAT) on transfers of goods and services carried out in the national territory for consideration and imports of goods which the investor will carry out shall also apply.

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*Do tax authorities take priority on enforcement?*

According to the tax enforcements code of Angola, the complaint of the acts of the tax enforcement process on the grounds of suspension foreseen in the tax enforcement code are considered urgent processes and, as such, they always run continuously, having priority before the other acts of the Court.

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*Is withholding tax on interest payments applicable?*

Yes, it is applicable, according to article 29 of the Capital Tax Code, the paying entity retains the rate of 10% of income and delivery to the state.

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*Are foreign lenders and debt security holders subject to tax on interest payments?*

Yes. Under the capital investment tax. Foreign lenders at a rate of 15%, and debt security holders at a rate of 10%.

In the first case: The tax is assessed by the holder of the income, except when they do not have a residence, registered office, effective management or fixed establishment in Angola, in which case it should be assessed by the debtor of the income.
Regarding the debt security holder, the liquidation is made by the entities that are responsible for the payment of the income, which are responsible for the totality of the tax and legal additions, in case of non-payment.

If such entities do not have a residence, head office, place of effective management or permanent establishment in Angola to which the payments are attributable, the beneficiary of the income shall be liable to pay the tax.

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Key contacts

Luís Filipe Carvalho
Partner
DLA Piper Africa, Angola (ADCA)
luis.carvalho@dlapiper.com
T: +244 926 612 525
Australia

Capital markets and structured investments

Issuing and investing in debt securities

*Are there any restrictions on issuing debt securities?*

The general position under the *Corporations Act 2001* (Cth) is that debt securities may only be offered and sold in Australia if they are accompanied by a disclosure document prepared in accordance with the *Corporations Act 2001* (Cth). Disclosure documents must be lodged with ASIC.

There are exceptions to the requirement to prepare a disclosure document which are outlined below.

The *Corporations Act 2001* (Cth) also imposes a general prohibition on the advertising or publicity of offers of securities that require a disclosure document. There are further prohibitions on 'hawking' (i.e. unsolicited meetings or telephone calls).

If debt securities are listed on the Australian Securities Exchange, there are additional disclosure requirements and continuing obligations that will apply – these are contained in the Listing Rules of the Australian Securities Exchange.

*What are common issuing methods and types of debt securities?*

The debt securities market in Australia includes stand-alone bonds and bond programs (e.g. Medium-Term Note programs) issued by large corporations and financial institutions.

Bonds may be issued in wholesale and retail formats. Wholesale issues do not require a prospectus or other disclosure document, and are rarely listed.

Many different types of debt securities are offered in the Australia, including guaranteed and asset-backed securities, high yield bonds, covered bonds, hybrid securities (including convertible notes and preference shares), derivative securities and green bonds.

Parties that are not resident in Australia may issue 'Kangaroo Bonds' (i.e. bonds issued in Australian dollars). In many cases, these issues are driven by favorable Australian dollar terms in the cross-currency swap markets.

Wholesale debt securities can be cleared through Austraclear, the Australian domestic clearing system. In order to be eligible, the securities must be issued in Australian dollars.

*What are the differences between offering debt securities to institutional / professional or other investors?*
Offers of debt securities can generally be made to institutional/professional investors without a disclosure document. Offers of debt securities to retail investors require a disclosure document prepared in accordance with the Corporations Act 2001 (Cth).

When is it necessary to prepare a prospectus?

The general position under the Corporations Act 2001 (Cth) is that debt securities may only be offered and sold in Australia if they are accompanied by a disclosure document prepared in accordance with the Corporations Act 2001 (Cth).

Offers of debt securities can generally be made to institutional/professional investors without a disclosure document.

Offers of debt securities to retail investors will require a disclosure requirement, most commonly in the form of a prospectus.

Even where a prospectus is not required by law, an information memorandum is commonly used for marketing purposes.

What are the main exchanges available?

The Australian Securities Exchange is the main exchange in Australia.

Is there a private placement market?

It is certainly possible to issue bonds through private placement in Australia, although domestic demand for such bonds is generally lower than in the US and Europe, due in part to a relative lack of liquidity. Many corporate issuers prefer to issue bonds in overseas jurisdictions.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for disclosure documents for debt securities. Liability may arise for breach of statute for statements that are misleading or deceptive, or omit any required information. In addition to the issuer, directors, underwriters, and other parties making statements in a defective disclosure document may also be liable for the damage arising from such defective disclosure.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee, which depending on the terms of issue may be exercised with or without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?
Generally

The Australian funds management industry is mature and heavily regulated. An Australian hedge or debt fund is usually structured as a unit trust and would ordinarily fall within the definition of a ‘managed investment scheme’ in the Corporations Act 2001 (Cth). That Act imposes a wide range of obligations and requirements on the operators of managed investment schemes. Managed investment schemes are regulated by ASIC.

Managed investment schemes

The following key restrictions apply when establishing a managed investment scheme:

- managed investment schemes, particularly those offered to ‘retail clients’ (as that term is defined in the Corporations Act 2001 (Cth)), are subject to relatively heavy regulatory requirements which may impose a significant compliance burden on the operators of such schemes;
- the operator of the managed investment scheme (which is called the ‘Responsible Entity’) must hold an Australian Financial Services License (AFSL) issued by ASIC (or be an authorized representative of another entity's AFSL) which authorizes it to act as the Responsible Entity of managed investment schemes;
- a managed investment scheme which is offered to retail clients must be registered with ASIC;
- if a managed investment scheme is structured as a unit trust (as is usually the case), general trust law will apply to the operation of the trust; and
- the offer of interests in a managed investment scheme to retail clients will require the preparation of a detailed disclosure document, the contents of which is heavily regulated.

Managed investment schemes may also be listed on the Australian Securities Exchange, provided that a range of regulatory requirements are met.

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What are common fund structures?

Unit trust

As noted above, the most common fund structure in Australia is a unit trust, where each investor holds units representing a beneficial interest in the assets of the fund.

Unit trusts are usually managed so they can be treated as ‘flow through’ vehicles for tax purposes (similar to a partnership) so that the fund itself is not subject to taxation. Investors are taxed on their share of the net income and capital gains earned by the fund.

Certain unit trusts that are managed investment schemes for Corporations Act 2001 (Cth) purposes may also qualify for tax concessions as a managed investment trust.

Collective investment vehicles

The Australian Government has been working on the introduction of an Australian collective investment vehicle (CIV) regime, which will introduce two alternatives to the current Australian unit trust structure. The new vehicles will be a corporate CIV and a limited partnership CIV, which will be similar to the equivalent structures which are commonly used in foreign jurisdictions.

The Australian Government is still conducting a consultation process (which began in 2017) with the most recent pieces of draft legislation outlining the proposed regime released in January 2019.

Asia Region Funds Passport

The Asia Region Funds Passport was implemented in Australia in 2018 with the Corporations Amendment (Asia Region Funds Passport) Act 2018 (Cth). It allows Australian fund managers to offer interests in qualifying funds to investors across multiple participating economies in the Asian region with limited additional regulatory requirements. Similarly, fund managers in other participating economies
will be able to market their qualifying funds to Australian investors using the more streamlined regulatory process.

However, the uptake of the Asia Region Funds Passport will largely depend on how the corresponding tax reforms and the CIV regime will look once enacted by Parliament.

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**What are the differences between offering fund securities to professional / institutional or other investors?**

**Distinction between retail and wholesale investors**

An investor is deemed to be a 'wholesale' investor for Australian law purposes where it has invested AUD500,000 or more in a particular fund. There are numerous other criteria for an investor to qualify as a 'wholesale' investor for Australian law purposes. For example, where an investor can produce a copy of a certificate given within the preceding two years by a qualified accountant that confirms that it has net assets of at least AUD2.5 million or has a gross income for each of the last two financial years of at least AUD250,000. Further, a person who has or controls gross assets of AUD10 million (including any assets held by an associate or under a trust that that person manages) is deemed to be a wholesale investor no matter what the size of its investment.

All investors that are not wholesale investors are considered to be retail investors.

**Retail funds**

Funds offered to retail investors must be registered with ASIC. The offer of interests in retail funds must be accompanied by a PDS, which must contain specific information as prescribed by the Corporations Act 2001 (Cth) (for example, information about the Responsible Entity, the fees and costs payable, the risks and benefits and significant characteristics of the fund). A PDS must also contain all other information that might reasonably be expected to influence the decision of a retail investor considering whether to invest in the fund.

**Institutional/professional funds**

Funds which are offered exclusively to wholesale investors do not need to be offered using a PDS. However, it is usual to provide another disclosure document, such as a private placement memorandum or information memorandum, when offering interests in such funds. Any such disclosure document must not be misleading or deceptive.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

As noted above, in order to establish a fund in Australia, the operator of the fund must usually hold an AFSL (or be an authorized representative of an AFSL holder) with appropriate license authorizations.

In addition, where the fund is a managed investment scheme (which is usually the case for retail funds), a Responsible Entity must be appointed. In order for an entity to act as a Responsible Entity, it must:

- be an Australian public company;
- hold an AFSL (or be an authorized representative of another AFSL holder) authorizing it to provide the various financial services relevant to the operation of the fund; and
- either have a majority of directors who are external directors or have a compliance committee (to oversee the retail fund's compliance requirements) with a majority of ‘external members’.

It is common for investment managers who do not satisfy the requirements for being a Responsible Entity to enter into an arrangement with an external or ‘professional’ Responsible Entity, which will operate the fund according to the investment strategy which the investment manager may set.
As mentioned, managed investment schemes may also qualify for tax concessions if they qualify as a "managed investment trust" under Australian tax laws. For a wholesale unit trust fund to qualify as a "managed investment trust", the trust must be operated or managed by an AFSL licensee or by an authorised representative of such licensee.

Investing in funds

As noted above, most investment funds in Australia are structured as unit trusts. These funds are subject to the general law of trust. In addition, usually:

- The investors in a fund have no power to influence the fund's investment strategy, or any of the decisions or operations of the fund, solely by virtue of being a unit holder.
- The investors in the fund do not have a specific right to any particular assets of the trust.
- The investors in the fund will rank behind the fund's creditors in the event of insolvency.
- The fund operator will usually be entitled to an indemnity from the assets of the fund for any liabilities it may incur in performing its duties, and will usually limit its liability to the amount by which it is actually indemnified.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

The marketing of a fund in Australia will normally constitute providing 'financial product advice' and so will be a 'financial service' for the purposes of the Corporations Act 2001 (Cth). That Act provides that, generally, all providers of financial services must hold an AFSL (or be appointed as an authorized representative of another AFSL holder) with an authorization to provide the relevant financial service.

When offering interests in retail funds it is also generally necessary to prepare a PDS.

Exemptions

There are a number of very limited exemptions from the need to obtain an AFSL or to act under an authorization from another AFSL in order to market a fund in Australia. These exemptions generally only apply when the fund is marketed solely to wholesale investors. For example:

- Certain foreign financial services providers who are regulated in jurisdictions that ASIC considers to have a regulatory framework sufficiently similar to the Australian regime (such as the UK, US, Singapore, Hong Kong and Germany) may be eligible to apply for relief from licensing to enable them to market funds to Australian 'wholesale' investors.

- An exemption applies where the marketing is done in Australia to a prospective investor which itself holds an AFSL and is not acting as a trustee or on behalf of another person (as Australian superannuation funds and Australian fund managers offer their products to their Australian investors through trusts, this limits the exemption to true proprietary investors which commonly do not have an AFSL as they are not usually required to hold one).

- An exemption applies where a prospective Australian investor makes enquiries of a foreign fund manager without any prior solicitation by the foreign fund manager, and the foreign fund manager does not during this time actively solicit persons in Australia in respect of the relevant fund (other than in response to the enquiry initiated by the Australian investor or by the Australian investor's agent).

Are there any restrictions on managing a fund?

2 ASIC is currently conducting a consultation process to formalise this exemption into a foreign financial services licence for foreign financial services providers. ASIC has proposed a prospective commencement date of 1 April 2020, however this is subject to the finalisation of the draft instruments proposed by ASIC.

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Australian domiciled funds will usually fall within the definition of 'managed investment scheme' in the Corporations Act 2001 (Cth). The Responsible Entity of a managed investment scheme (which is the operator of the fund) is typically required to hold an AFSL (or be an authorized representative of an AFSL holder) which authorizes it to provide the various financial services necessary to operate the fund, including a specific authorization to act as the Responsible Entity of a managed investment scheme.

As noted above an entity wishing to act as the Responsible Entity of a managed investment scheme must also:

- be an Australian public company; and
- either have a majority of directors who are external directors or have a compliance committee (to oversee the retail fund's compliance requirements) with a majority of ‘external members’.

An investment manager which is not able to act as a Responsible Entity may enter into an arrangement with an external or ‘professional’ Responsible Entity, which will operate the fund according to the investment strategy which the investment manager may set. In those situations, from a strictly legal perspective, it is the Responsible Entity of a retail fund that engages the investment manager and is responsible for the acts of the investment manager, and the Responsible Entity will bear any liability for the mismanagement of the fund. Such external Responsible Entities will therefore typically charge a significant fee for their service.

If a managed investment scheme is to be offered to retail investors, it must be registered with ASIC and will be subject to a further layer of regulatory requirements. For example, a registered managed investment scheme must have a ‘constitution’ which is compliant with the Corporations Act 2001 (Cth) and must also maintain a ‘compliance plan’ which sets out the measures which the Responsible Entity must take to ensure compliance with the constitution and the Corporations Act 2001 (Cth).

The offer of interests in a managed investment scheme to retail investors will also generally require certain disclosure documents, including a PDS, to be prepared in accordance with the content requirements mandated by the Corporations Act 2001 (Cth) and by ASIC.

As mentioned, managed investment schemes may also qualify for tax concessions if they qualify as a “managed investment trust” under Australian tax laws. For a wholesale unit trust fund to qualify as a “managed investment trust”, the trust must be operated or managed by an AFSL licensee or by an authorised representative of such licensee. For a managed investment trust that seeks the 15% concessionally withholding tax rate for its fund payments, a substantial proportion of its investment activities must also be carried out in Australia.

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Entering into derivatives contracts

*Are there any restrictions on entering into derivatives contracts?*

Unless an exemption or exclusion applies, a person issuing derivatives as part of its financial services business is deemed to be dealing in financial products, which requires an AFSL under the Corporations Act 2001 (Cth) and the Corporation Regulations 2001 (Cth). If a person issues derivatives without an AFSL, the counterparty would be entitled to rescind any agreements in relation to that product and the relevant agreements will be unenforceable. There are specific financial requirements for a person authorized to issue derivatives, which differ from requirements in relation to other financial products, which recognize the exposure of the licensee to counterparties arising from entering into derivatives.

For these purposes, a ‘derivative’ is broadly defined as an arrangement that has a future liability element and a derived value element, and is sufficiently wide to cover all commonly-regarded types of derivative contracts, including futures agreements and forwards, options, swaps and contracts for difference. Under the relevant legislation, certain arrangements are specifically excluded as derivatives including:

- arrangements for mandatory physical delivery of tangible property;
- a contract for the future provision of services; and
- anything that falls within one of the other categories of financial product (such as a security).

AFSL licensees have ongoing obligations under the Corporations Act 2001 (Cth) in terms of their conduct, including to:

- notify the ASIC of breaches or likely breaches of certain significant licensee obligations;
- quote their AFSL number in documents;
What are common types of derivatives?

Derivative contracts are entered into in Australia for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in Australia, including futures agreements and forwards, options, swaps (including credit default swaps) and contracts for difference. Underlying assets commonly include equities, fixed income instruments, commodities, foreign currencies and credit events.

The gross notional outstanding for interest rate derivatives in Australia is worth in excess of AUD10 trillion, the majority of which are denominated in AUD. There is also a sizeable FX swap market, with average daily turnover in excess of AUD100 billion.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, and the G20 summit in 2009 the derivatives market has been subject to a significant amount of new regulation, and this has led to substantial compliance costs for market participants.

In January 2013, ASIC introduced the ASIC Derivative Transaction Rules (Reporting) 2013, together with the ASIC Derivative Trade Repository Rules 2013. Among other things, these Rules introduced mandatory reporting requirements for derivative transactions for the majority of derivatives users. These rules were subsequently softened by the ASIC Derivative Transactions Rules (Reporting) Amendment 2015 (no 1).

Other recent regulatory changes of note include the requirement for certain standardized over-the-counter derivative trades to be subject to clearing with a prescribed Central Clearing Counterparty, as implemented through the Corporations (Derivatives) Amendment Determination 2015 (No 1), and the requirement for reporting of certain trades to a licensed Trade Repository, as implemented through the Derivative Transaction Rules (Reporting) 2013 (both regulations have been subject to subsequent amendment).

The Prudential Standard CPS 226 (Margining and risk mitigation for non-centrally cleared derivatives), as published by the APRA in 2016, establishes the requirement for the posting and collection of variation and initial margin in transactions which include a covered entity (for example, deposit-taking institutions that are authorized under the Banking Act 1959 (Cth)).

In addition, it is important to note that the approach to market misconduct is generally the same for securities and for derivatives (including market manipulation and insider trading) although compensation orders for damages do not apply to derivatives.

Finally, the ATO has recently issued guidelines setting out risk factors applicable to cross-border related party derivatives.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

While there are no general restrictions on lending, a lender may need to comply with various codes or regulations if engaging in certain lending practice, particularly if lending to individuals or consumers. The most important to note are as follows:
• The National Credit Code applies to credit contracts entered into by natural persons or strata corporations, for personal domestic or household purposes or the purposes of residential improvement. The National Credit Code imposes a range of regulatory requirements on the lender that do not apply to loans that fall outside its scope. Those outside its scope generally include loans to companies and loans predominately for business or investment purposes.

• The Banking Code of Practice (BCOP) of the Australian Banking Association (ABA) came into effect on 1 July 2019. It is effectively a complete rewrite of the previous 2013 Code of Banking Practice. Although the BCOP is voluntary, each ABA member bank with a retail presence in Australia is required to subscribe to the BCOP as a condition of its ABA membership. The BCOP is binding and the BCOP rules form part of the contractual relationship between the bank and its customer. The BCOP applies to specified banking services provided to individual customers, small businesses, and guarantors and prospective guarantors in respect of a loan to an individual or small business. Affected “banking services” include bank accounts, term deposits, credit and debit cards, home and personal loans, overdrafts, bill facilities, consumer credit insurance and payment and forex services. However, “banking services” expressly excludes shares, bonds and securities, as well as financial products and services provided to wholesale customers.

• An Australian credit license must be held by any person engaging in the provision of consumer ‘credit activities’ (including supplying goods on credit). Licensees must comply with a number of general conduct obligations and responsible lending guidelines.

• The Banking Act 1959 (Cth) and various legislative and prudential requirements must be adhered to for a lender to be a ‘bank’ or to operate as a deposit taking institution. A person must not hold itself out to be a ‘bank’ unless authorized to do so.

1A business is a “small business” if at the time it obtains the banking service all of the following apply:

   a) it had an annual turnover of less than AUD10 million in the previous financial year; and
   b) it has fewer than 100 full-time equivalent employees; and
   c) it has less than AUD3 million total debt to all credit providers including:
      i. any undrawn amounts under existing loans;
      ii. any loan being applied for; and
      iii. the debt of all its related entities that are businesses.

Borrowing

While borrowers are generally not regulated, it is advisable for a borrower to consider whether the National Credit Code or the BCOP apply to his, her or its activities, in which case various protections may be available.

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What are common lending structures?

Lending in Australia may be structured in a number of different ways to include a variety of features, depending on the commercial aims of the parties.

A loan may be provided on a bilateral basis (a single lender providing the entire facility), a syndicated basis (multiple lenders each providing a portion of the overall facility) or a club basis (multiple lenders lending bilaterally in parallel).

Syndicated facilities by their nature involve more parties (such as an arranger, an agent and a security trustee which each carry out a specific role for the syndicate banks), are more highly structured and involve more complex documentation. Large financings will typically be done on a syndicated basis, with one of the syndicate taking the lead in coordinating and arranging the financing.

Club facilities involve multiple lenders lending bilaterally to the borrower in parallel to each other on materially similar terms. Club facilities usually do not involve a facility agent (at least for payment purposes) and they lack syndication terms which dictate funding mechanics, payment distribution, sharing provisions and lender voting regimes. A club facility may be documented in a variety of ways, including by:

• a deed of common provisions which are adopted wholly or in part by each lender under its facility agreement;
• individual, but largely identical, bilateral loan agreements; and
• a single document similar to syndicated loan agreement, but without a payment agent or syndication terms.

Loans will be structured to achieve the borrower's specific funding objectives. For example, they may be term loans, revolving credit facilities, working capital loans, equity bridge facilities, project facilities and letter of credit facilities, to name a few.

### Loan durations

Typically, the Australian banking market accommodates commercial loan tenors of three to five years. Longer-term debt may be available in limited circumstances.

The duration of a loan may also be determined by its type. For example, typically:

• a term loan is provided for an agreed period of time but with a short availability period;
• a revolving credit facility is provided for an agreed period of time with an availability period that extends nearer to the date of its maturity. It may be redrawn if repaid;
• an overdraft is provided on a short-term basis to solve short-term cash flow issues;
• a standby or a bridging loan is intended to be used in exceptional circumstances when other forms of finance are unavailable. It often attracts a higher margin; or
• a cash advance, provided on a short-term basis to cover short-term cash flow issues and often attracting a higher margin.

In Australia, bill facilities are also used sometimes and they operate with bills maturing and ‘rolling over’ at set intervals (usually 30, 60, 90 or 180 days). Historically, loan note facilities have also been made available for stamp duty or income withholding tax purposes.

### Loan security

A loan may be either secured, unsecured (including on a ‘negative pledge’ basis) or guaranteed.

### Loan commitment

A loan may be:

• committed, meaning that the lender is obliged to provide the loan if certain limited conditions are fulfilled. Conditions precedent will be set out in the loan agreement; or
• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

No conditions precedent will be set out in the loan agreement.

### Loan repayment

A loan may be repayable:

• on demand,
• on an amortizing basis (that is, in instalments over the life of the loan or as may be scheduled); or
• upon maturity (commonly referred to as a ‘bullet loan’).

### What are the differences between lending to institutional / professional or other borrowers?

Consumer and small business lending is generally heavily regulated, requiring necessary licenses and compliance obligations.

By contrast, lending to institutional or professional borrowers is subject to less regulatory oversight and is less burdensome from a compliance perspective.
Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized under Australian law. Relationships based on the principles of agency and trust are commonly found in Australian financing transactions.

For example, in a syndicated financing, the syndicate will appoint an agent (usually the arranging bank) to act on behalf of the syndicate banks.

The agent will coordinate activities relating to the loan repayments, correspondence between the borrower and the syndicate banks and other matters. The syndicated loan documentation will typically contain provisions defining the nature of the agent's appointment and the scope of its authority and liabilities.

In a secured syndicated financing, the security will be granted in favor of a security trustee which will hold the security on trust for the benefit of the banks.

Borrowers are also commonly trustees, particularly in the real estate investment sector.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general statutory, contractual and common law principles.

Australian courts will not enforce a penalty in a loan agreement. Lenders must therefore be careful when determining the rate of default interest and the amount of any cancellation, prepayment or similar fees.

A lender should be aware that, even if it is rightfully exercising its rights under the loan agreement, the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act) prohibits persons from engaging in unconscionable conduct or morally wrong behavior. In determining what constitutes unconscionable conduct, the court will consider the bargaining power of the parties, the parties' respective abilities to understand the documents and the lender's disclosure of certain risks.

Unfair contract legislation

The Australian Consumer Law and the ASIC Act regulate unfair contract terms found in standard form contracts entered into or renewed after 12 November 2016 where:

- it is for the supply of goods or services or the sale or grant of an interest in land;
- at least one of the parties is a small business (employs less than 20 people, including casual employees employed on a regular and systematic basis); and
- the upfront price payable under the contract is no more than AUD300,000 or AUD1 million if the contract is for more than 12 months.

A standard form contract is a contract that is prepared by one party where the other party has little or no scope to negotiate the terms of the contract. If a court declares a term of a standard form contract to be unfair, the term will be void and the contract will continue to operate unless it is inoperable without the void term. Consumers and Australian Consumer Law regulators are able to claim for damage incurred as a consequence of the unfair contract term.

In the context of financing transactions, the unfair contract legislation will be primarily relevant to home loans and small to medium sized commercial loans documented on the lender’s standard form documentation.

Specific types of lending

ACQUISITION FINANCE
An Australian company may not provide financial assistance to a person to purchase shares in the company itself or its holding company (even if that holding company is incorporated outside of Australia) unless the financial assistance:

- does not materially prejudice the company, its shareholders or its ability to pay its creditors (the ‘no material prejudice’ exception);
- has been approved by the company's shareholders in accordance with the 'whitewash' procedure prescribed by the Corporations Act 2001 (Cth); or
- falls within a specified exemption. A common example of prohibited financial assistance is the granting of a guarantee or security by a company whose shares are being purchased in support of a loan advanced by a financier to the purchaser to fund the share acquisition.

Companies and their financiers do not generally rely on the 'no material prejudice' exception and the specified exemptions are only sometimes relevant. Instead, the common practice in Australia (and the prudent approach) is for the company to obtain shareholder approval of the financial assistance by way of the whitewash procedure. The whitewash procedure in Australia can be more time consuming and complex to implement than equivalent procedures in other jurisdictions.

A breach of the financial assistance prohibition will not affect the validity of the transaction, but may result in civil and criminal sanctions.

THE PERSONAL PROPERTY SECURITIES ACT 2009 (CTH) (PPSA)

The PPSA came into effect on 2012 and it comprehensively overhauled the laws then in force for taking security over personal property in Australia. The PPSA has been modelled on the equivalent Canadian and New Zealand statutes and it bears much resemblance to Article 9 of the US Uniform Commercial Code.

The PPSA adopts a substance-over-form definition of ‘security interest’, which captures not only traditional forms of security, such as charges and mortgages, but also quasi-security arrangements, such as turnover trusts and retention of title. The PPSA also deems certain other arrangements to be security interests, such as leasing or bailment interests and the interests in assigned receivables. Each of these types of ‘security interests’ should be perfected, most commonly by registration on the Personal Property Securities Register, to ensure that it operates effectively upon the grantor's insolvency or liquidation. It is important to give careful consideration to whether a registrable form of ‘security interest’ under the PPSA arises in the relevant transaction.

Standard form documentation

Most syndicated finance transactions in Australia are documented on the basis of recommended form Australian law documentation published by the Asia Pacific Loan Market Association (APLMA). This documentation has been modelled on the recommended forms produced by the Loan Market Association in London.

Less complex and usually bilateral transactions are generally documented on bank standard form documentation prepared in-house or on bespoke facility documentation prepared by the advising solicitors.

The Banking & Financial Services Law Association (BFSLA) has produced standard templates for legal opinions in financing transactions and these are generally followed in the Australian market.

Are there any other notable risks or issues around borrowing?

There are limited restrictions on borrowing in Australia. However, depending on the nature of the transaction, the following issues may need to be considered:

- foreign investment approval;
- superannuation funds general prohibition from borrowing money;
- financial assistance;
- loans to directors;
- corporate benefit rules; and
Giving and taking guarantees and security

**Are there any restrictions on giving and taking guarantees and security?**

Some of the key areas affecting the giving and taking of guarantees and security are as follows.

**Corporate benefit**

A transaction may be voidable if there is no corporate benefit to the entity. The presence of corporate benefit is a factual matter.

Corporate benefit is a particular issue for guarantees. Each director owes a duty to the company to act for the benefit of the company in its best interests, with due care and diligence, in good faith and for a proper purpose. Each director must also avoid any conflict between his or her personal interests and those of the company. These duties must be observed when it is proposed that a company grants a guarantee of the obligations of another.

In deciding whether to grant a guarantee (or provide third party security), the directors may consider both direct and indirect benefits flowing to the company. For example, in the context of a corporate group, the granting of a guarantee might indirectly benefit the guarantor if it is a requirement for the support of a related company and benefits flow back to the guarantor. Note that corporate benefit must be assessed at the level of the individual company – i.e. it is not sufficient that the guarantee benefits the group as a whole.

A director of a wholly-owned subsidiary may take into account the best interests of its holding company so long as the company's constitution permits him or her to act in the best interests of the holding company and the subsidiary is solvent.

It may be possible to address concerns regarding the presence of corporate benefit by obtaining shareholder approval for the transaction.

A guarantee that does not benefit the company commercially may be voidable. Further, the guarantee could be held to be an unfair preference or uncommercial transaction. The directors could be subject to civil and criminal penalties and personal liability.

**Insolvency and voidable transactions**

If a lender enters into a secured transaction shortly before the company becomes insolvent, unsecured creditors may be able to challenge the security on the basis that the grant of security constituted an unfair preference or an uncommercial transaction. Unfair preferences and uncommercial transactions are both voidable. If the unsecured creditors are successful, the lender will not be able to have recourse to the purportedly secured assets and they will be distributed amongst all creditors, including the unsecured creditors. The rules are technical and the following is a simplified outline.

Unfair preferences arise where one creditor is unfairly preferred over others.

Uncommercial transactions do not involve creditors as such, but aim to recover any disposals of assets at an undervalue.

The transaction must have been entered into while the company is insolvent, or the company must have become insolvent as a consequence of the transaction. It must also have been entered into during the period ending on the ‘relation-back day’, but on or before the winding up process began. For unfair preferences, the period is six months, and for uncommercial transactions, it is two years. In each case, the period is four years in the case of related parties and 10 years if the transaction was entered into to avoid the rights of creditors. The relevant period is known as the ‘hardening period’.
After the end of the hardening period, the transaction is no longer vulnerable to being voided.

Financial assistance

An Australian company may not provide financial assistance to a person to purchase shares in the company itself or its holding company (even if that holding company is incorporated outside of Australia) unless the financial assistance:

- does not materially prejudice the company, its shareholders or its ability to pay its creditors (‘no material prejudice’ exception);
- has been approved by the company’s shareholders in accordance with the ‘whitewash’ procedure prescribed by the Corporations Act 2001 (Cth); or
- falls within a specified exemption.

A common example of prohibited financial assistance is the granting of a guarantee or security by a company whose shares are being purchased in support of a loan advanced by a person financier to the purchaser to fund the share acquisition.

Companies and their financiers do not generally rely on the ‘no material prejudice’ exception and the specified exemptions are only sometimes relevant. Instead, the common practice in Australia (and the prudent approach) is for the company to obtain shareholder approval of the financial assistance by way of the whitewash procedure. The whitewash procedure in Australia can be more time consuming and complex to implement than equivalent procedures in other jurisdictions.

A breach of the financial assistance prohibition will not affect the validity of the transaction, but may result in civil and criminal sanctions.

Related party transactions

Chapter 2E of the Corporations Act 2001 (Cth) is intended to preserve and maintain the assets or resources of public companies by requiring that, in simple terms, financial benefits passed to related parties that might diminish or adversely affect those assets or resources are disclosed and approved by a general meeting of the public company beforehand.

The provisions are detailed, but essentially a public company (or an entity controlled by a the public company) may only give a financial benefit to a related party of the public company if:

- the benefit falls within one of the seven categories of exempted financial benefit (e.g. arm’s-length terms, pursuant to a court order); or
- if the benefit is of any other kind, the public company has obtained the approval of its members to give the benefit or to enter into a contract to give the benefit.

Failure to comply with the related party transactions laws will not affect the validity of the transaction, but it may render any person involved liable for a civil or criminal penalty.

National Credit Code

The National Credit Code applies to credit contracts entered into on or after 1 July 2010 where:

- the lender is in the business of providing credit;
- a charge is made for providing credit;
- the debtor is a natural person or strata corporation; and
- the credit is provided for personal or domestic use or to purchase, renovate or improve residential property for investment purposes or refinance credit previously provided for this purpose.

There are certain confined exemptions (e.g. for low cost short term credit). The Code does not apply to business loans.

Where the National Credit Code applies there are restrictions on the guarantees that a lender may obtain from a customer. For example, a guarantee from an individual must be limited (in terms of the amount the lender can recover) to the amount of the relevant loan plus interest, charges, costs and expenses. There also are various disclosure and other obligations that the lender must comply with. Failure to
comply may render the guarantee or security unenforceable.

**Banking Code of Practice**

The restrictions noted above apply in a similar manner under the 2019 BCOP, the ABA's voluntary code of practice which is mandatory for retail banks to adopt as a condition of their membership of the ABA and which is enforceable by law. Similar to the National Credit Code, a bank that is a signatory to the BCOP may only accept a guarantee which is limited to (a) a specific amount or category of amounts (such as all amounts owing under a specific loan) plus other amounts (such as interest and recovery costs) or (b) the value of a specified property or other asset under a specified security at the time of recovery.

**Foreign lenders**

There are technical restrictions on the foreign ownership of Australian assets and companies set out in Australia's foreign investment legislation, namely the Foreign Acquisitions and Takeovers Act 1975 (Cth). Foreign lenders and foreign entities taking the benefit of security over Australian assets should consider the possible application of this legislation, which is administered by FIRB. Notification to FIRB and FIRB approval may be required in some cases before a foreign entity takes or enforces security. Particular issues arise for foreign government investors upon enforcement.

There is a fairly broad ‘moneylender’ exemption for lenders. In simplified terms, if security over Australian assets is held in the ordinary course of carrying on a business of lending money and solely by way of security for the purposes of a ‘moneylending agreement’, the moneylender exemption will generally apply. This exemption also applies to the acquisition of an interest in an Australian asset arising by way of enforcement of a security interest held solely for the purposes of a moneylending agreement.

A moneylending agreement is defined as:

- an agreement entered into in good faith, on ordinary commercial terms and in the ordinary course of carrying on a business (a moneylending business) of lending money or otherwise providing financial accommodation, except an agreement dealing with any matter unrelated to the carrying on of that business; and

- for a person carrying on a moneylending business, or its subsidiary or holding entity, an agreement to acquire an interest arising from a moneylending agreement as described above.

Where the exemption applies, notification and FIRB approval are not required when taking or enforcing the security.

There are limits on how long the foreign government investors may hold onto an interest upon enforcement. For these investors, the moneylender exemption requires in effect that, if its interest is acquired by way of enforcement of a security, that interest must disposed of, or a genuine sale process commenced, within six months of the acquisition (or 12 months in the case of an authorised deposit-taking institution). If this does not occur, separate FIRB approval is required. The concept of ‘foreign government investor’ is broadly defined and potentially easily triggered. For example, it could include a trustee of a trust in which a foreign government holds a substantial interest and general partner of a limited partnership in which a foreign government holds (alone or with associates) at least a 20% interest (or 40% or more where there is more than one foreign government).

Failure to obtain FIRB approval, if required, could give rise to penalties, an unwinding of the transaction or an order for the disposal of assets.

**Critical infrastructure**

If the security is taken over a ‘critical infrastructure asset’, which includes approximately 200 electricity, gas, water and port assets, then a secured creditor may have reporting obligations under the Security of Critical Infrastructure Act 2018 (Cth) if it is in a position to directly or indirectly influence or control the asset.

*Last modified 3 Dec 2019*

**What are common types of guarantees and security?**

**Common types of guarantees**

Guarantees may take a number of forms, including the following.
GUARANTEES AND INDEMNITIES

Guarantees taken in support of loan facilities typically include both guarantee and indemnity provisions (albeit the document may be described simply as a ‘guarantee’). A guarantee is a promise by the guarantor to ensure that the borrower fulfils its obligations under the facility agreement (primarily to repay the loan) and a promise by the guarantor to fulfil those obligations if the borrower fails to do so. The borrower’s obligations are primary and the guarantor’s obligations are secondary. A guarantee is contingent on the borrower’s primary obligation remaining valid, so that if for any reason the borrower’s obligations are set aside, the guarantee will also fall away. An indemnity is also a promise to be responsible for another’s loss. However, unlike a guarantee, it is a primary obligation given by the indemnifier in favour of the beneficiary. It is not contingent on the borrower’s obligations remaining on foot. Therefore if the borrower’s obligations are set aside for any reason, the indemnifier will remain liable under the indemnity.

This category may include a parent guarantee and indemnity, whereby a parent company or sponsor promises to be accountable for its subsidiary’s obligations. A parent guarantee and indemnity is sometimes limited by its terms or operation.

PERFORMANCE GUARANTEES

A guarantor’s promise to be accountable for the performance of an act or contractual obligation of another individual. For example, a completion guarantee ensuring that completion of the project occurs on a specified date. This is distinct from a traditional guarantee only in so far as the guarantee usually is limited to performance obligations (rather than payment obligations) and, with the exception of damages, the guaranteed beneficiary’s recourse is limited to demanding performance (rather than payment).

BANK GUARANTEES

An unconditional and irrevocable undertaking by a bank in favour of a named beneficiary to make a payment upon receipt of a complying demand from the beneficiary. The bank will then seek reimbursement from its customer under the terms of the indemnity contained in the facility agreement between the bank and the customer.

PERFORMANCE BONDS

An irrevocable undertaking by a financial institution to pay an amount on demand or, in some cases, on the condition that the performance obligations of its customer are not met.

Common types of security

Security may be granted over almost all types of assets in Australia, subject to any contractual or statutory restrictions. The most commons forms of security are as follows.

MORTGAGES OVER LAND

State and Territory real property legislation applies. Mortgages of real property must be registered with the land titles office of the State or Territory in which the land is situated. Mortgages of leasehold interest in land must also (in most cases) be registered with the relevant land title office.

Mandatory electronic lodgement of land dealings, including mortgages, is currently being rolled out across Australia.

SECURITY OVER PERSONAL PROPERTY

The following forms of security over personal property are governed by the Personal Property Securities Act 2009 (Cth) (PPSA):

- a general security agreement, where the collateral is all of a grantor’s personal property; and
- a specific security agreement, where the collateral is specific personal property of a grantor, such shares, book debts, plant or motor vehicles.

The PPSA adopts a substance-over-form definition of ‘security interest’, which captures not only traditional forms of security, such as charges and mortgages, but also quasi-security arrangements, such as turnover trusts and retention of title. The PPSA also deems certain other arrangements to be security interests, such as leasing or bailment interests and the interests in assigned receivables. Each of these
types of ‘security interests’ should be perfected, (most commonly by registration) on the Personal Property Securities Register, to ensure that it operates effectively upon the grantor’s insolvency or liquidation. It is important to give careful consideration to whether a registrable form of 'security interest' under the PPSA arises in the relevant transaction.

Are there any other notable risks or issues around giving and taking guarantees and security?

Guarantees

In most Australian States and Territories, a guarantee must be in writing and be signed by the guarantor.

Parties should be careful not to inadvertently discharge the guarantor from its liabilities under the guarantee when making variations to the underlying loan facility agreement. A guarantor may be released from its guarantee if the underlying facility agreement is varied, save if the variation is immaterial or incapable of prejudicing the guarantor. This is the case even if the guarantor (a) agrees in the guarantee to variations being made to the underlying facility agreement without its consent and (b) is aware of the variations being made. The guarantor should acknowledge the variations to the loan agreement at the time they are made and affirm that its liabilities under the guarantee remain in full force.

Security

MORTGAGES OF REAL PROPERTY

Mortgages of real property must be registered with the land titles office of the State or Territory in which the land is situated. Failure to register may result in the mortgagee losing priority to prior registered interests. Priority between registered interests is generally determined in order of registration. Accordingly, mortgagees should not delay in registering.

SECURITY OVER PERSONAL PROPERTY

Where the PPSA applies, security interests in personal property should be ‘perfected’. Security interests may be perfected by registration or, in some circumstances, by control (e.g. for certain financial assets) or possession (e.g. for goods and some intangible rights) of the collateral. Registration on the Personal Property Securities Register is the most common method of perfection.

It is not mandatory to perfect a security interest under the PPSA. However, if a security interest is not registered or not registered within an applicable timeframe (and not otherwise perfected), then (a) it may vest in the grantor immediately upon the grantor being wound up or entering into voluntary administration, a deed of company arrangement or bankruptcy or (b) a third party may acquire an interest in the collateral free from the security interest.

Registration is also relevant to the priority of security interests. A security interest that is not registered (or otherwise perfected) will lose priority to a security interest that is perfected. Generally, priority between security interests perfected by registration (that are otherwise equal in priority) is determined by the order of registration. Therefore it is important for secured parties to register as soon as, if not before, the security agreement is executed. Certain types of security interests are given 'super priority'. An example is a supplier’s security interest in goods that it has delivered to a customer (the grantor) on a retention of title basis. This is called a ‘purchase money security interest’ (PMSI) and, if perfected, has priority over non-PMSIs. This applies also to the interests of lessors or bailors. A PMSI must be specifically registered as a PMSI to be effective in this manner.

The registration requirements under the PPSA are very prescriptive. Failure to register correctly or and errors in a registration, (for example, in a grantor's details,) can render a registration ineffective.

The broad definition of ‘security interest’ under the PPSA means that the rules regarding registration and perfection apply to many arrangements that, prior to the PPSA, were not considered security interests. Failure to recognize the existence of, and in-turn to perfect, security interests can have significant consequences for the transacting parties.
A secured creditor has better rights on enforcement if it has a charge over the whole or substantially the whole of the grantor's property. During an administration period, subject to certain exceptions, the Corporations Act 2001 (Cth) imposes a statutory moratorium that prevents security from being enforced against the company's assets, save with the administrator's written consent or with the court's leave. The main exception to the moratorium is that a secured creditor with a charge over the whole, or substantially the whole, of the company's property may enforce it during the 'decision period' (being 13 business days from the time notice of the administrator's appointment is given to the charge, or from the time the administration starts). It is therefore common practice for a lender to obtain security over all or substantially all of the company's assets so as to avoid the risk of moratorium on enforcement of security during an administration. A featherweight charge also addresses administration risk.

‘Ipso facto’ stays

The recent ‘ipso facto’ reforms in Australia may impact on the ability of a lender to enforce upon certain insolvency events occurring in respect of the borrower. From 1 July 2018, new provisions in the Corporations Act 2001 (Cth) have imposed a stay on the enforcement of ‘ipso facto’ clauses against a company if it becomes subject to certain insolvency procedures, namely a substantial receivership or controllership, a voluntary administration or a scheme of arrangement.

An ‘ipso facto’ clause enables a party to terminate a contract or exercise other rights by virtue of the fact the other party becomes insolvent or subject to an insolvency process. An example in a typical facility agreement would be an event of default triggered by the appointment of a receiver to all of the borrower's assets. The new stay on the enforcement of ipso facto clauses is intended to give companies the space to recover from insolvency without the threat of major contracts being terminated. A party will not be able to enforce an ipso facto clause if the reason for doing so is because (a) the company has entered into the relevant insolvency procedure (b) the company's financial procedure during the procedure (c) a reason prescribed by regulations or (d) a reason that, in substance, is contrary to the stay (this being an anti-avoidance measure). The stay also extends to rights that arise automatically without a party taking action (known as 'self-executing' rights).

There are a number of exceptions and carve-outs. Most relevantly, it does not apply to (a) syndicated loans or bonds, (b) variations to contracts made prior to 1 July 2018, (c) enforcement by a secured creditor holding security over the whole or substantially the whole of the company's assets (d) enforcement against guarantors and third party security providers (e) drawstops under a facility agreement, meaning that the lender is not obliged to advance new monies (f) arrangements entered into during the relevant procedure and (g) a right exercised with the consent of the court or the administrator, scheme administrator, liquidator or other relevant officer.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Australian Securities and Investments Commission Act 2001 (Cth)
Australian Securities Exchange Listing Rules
Australian Prudential Regulation Authority Act 1998 (Cth)
Banking Act 1959 (Cth)
Banking Code of Practice
Competition and Consumer Act 2010 (Cth)
Corporations Act 2001 (Cth)
Customer Owned Banking Code of Practice
ePayments Code
Financial Sector (Collection of Data) Act 2001 (Cth)
Financial Sector (Shareholdings) Act 1998 (Cth)
Financial Sector (Transfer and Restructure) Act 1999 9 (Cth)
Financial Services Reform Act 2001 (Cth)
Foreign Acquisitions and Takeovers Act 1975 (Cth)
Payment Systems (Regulation) Act 1998 (Cth)
Payment Systems and Netting Act 1998 (Cth)
Reserve Bank Act 1959 (Cth)

Consumer credit

Banking Code of Practice
Competition and Consumer Act 2010 (Cth)
National Consumer Credit Protection Act 2010 (Cth)

Mortgages and other security interests

Banking Code of Practice
National Consumer Credit Protection Act 2009 (Cth)
Personal Property Securities Act 009 (Cth)

Corporations

Corporations Act 2001 (Cth)
Superannuation Act 1976 (Cth)
Superannuation Industry (Supervision) Act 1993 (Cth)

Taxation

Income Tax Assessment Act 1997 (Cth)
Income Tax Assessment Act 1936 (Cth)
Income Tax Assessment Act 1953 (Cth)

Funds and platforms

Corporations Act 2001 (Cth)

Other key market legislation

Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)
Privacy Act 1988 (Cth)

NB Reference to an Act refers to all regulations under that Act.

Last modified 26 Feb 2020

Regulatory authorization

Who are the regulators?

Regulation of the financial services sector is split between the Reserve Bank of Australia (RBA), the Australian Prudential and Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).

The RBA is Australia's central bank and responsible for the overall stability of financial markets and monetary policy.

APRA has the responsibility of supervising Australia's Authorized Deposit Taking Institutions (ADIs), with the primary task to ensure that organizations in the banking and financial services sector manage their risk appropriately.
ASIC has responsibility for the supervision of operators of financial markets, clearing and settlement facilities, and market participants. It advises the Australian government on licensee operating rules as well as on new market and clearing and settlement facility operators. ASIC's other main role is to regulate consumer protection in the financial sector.

Other regulators to note are:

- the Australian Transaction Reports and Analysis Centre (Austrac); and
- the Australian Competition and Consumer Commission (ACCC).

Austrac is the regulator and specialist financial intelligence unit responsible for regulation of anti-money laundering and counter-terrorism financing.

The ACCC is the national agency responsible for enforcing the Competition and Consumer Act 2010 (Cth)(CCA), Australia's key legislation in respect of trade practices. The ACCC regulates anti-competitive and unfair market practices, mergers or acquisitions of companies, consumer protection (including product safety) and third-party access to facilities of national significance.

**What are the authorization requirements and process?**

**Australian Financial Services (AFS)**

If an entity wishes to carry on a financial services business, it will have to apply to the ASIC for an AFS license or have the benefit of an exemption. Financial services include advice and dealing in respect of financial products such as investment products, non-cash payment facilities and arrangements for the management of financial risk.

To apply for a license, the entity is required to lodge an application form and a suite of proof documents (i.e. business descriptions, organizational structures, people proofs and financial statements). In some cases, ASIC may require additional information, and request the entity lodge further proof documents or answer specific questions in relation to the documents submitted with ASIC.

When evaluating an application for an AFS License, ASIC will assess if the entity:

- is competent to carry on the type of financial services indicated in the application;
- has sufficient resources to carry on the business; and
- can meet the obligations of an AFS licensee (i.e. training, compliance, insurance and dispute resolution).

The application fee depends on the type of application and, as at December 2019, ranges from AUD899 (i.e. paper lodgement for a request to cancel a body corporate AFS license), AUD3,721 (i.e. online application for a body corporate AFS license for retail clients and low complexity products) to AUD11,305 (i.e. paper lodgement for a body corporate AFS license for retail clients and high complexity products).

The application process takes around five to eight months in total, depending on the type of application lodged.

Firms which hold AFS Licenses are listed on the ASIC register.

**Australian Prudential and Regulation Authority**

If an entity wishes to carry on a banking business in Australia it is required to be authorized by APRA as an 'authorized deposit-taking institution' (ADI) or have the benefit of an exemption.

To apply for authorization, the applicant must:

- engage in a preliminary consultation with APRA to discuss the applicant's intention to engage in banking business in Australia;
- lodge an application and required documentation with APRA; and
- arrange meeting(s) with APRA to complete an onsite review.

The application fee depends on the type of application and ranges from AUD30,000 to AUD80,000.
The time required to process an application is dependent on the nature of the application and the supporting documents required to be provided to APRA. APRA states that generally the overall licensing process could take from three to twelve months.

Institutions classified as ADIs are listed on the APRA website.

Engagement with APRA prior to an application being made is recommended.

**Credit**

Credit providers and intermediaries require an Australian Credit License to provide credit or financial broking services (unless they are exempt). The credit licensing system is based on the AFS licensing concepts and requirements as ASIC is now the national regulator for consumer credit and finance broking.

To apply for a license, the entity will be required to lodge an application, answer questions in relation to proposed credit activities, provide supporting documents regarding employees and operations and provide a declaration the entity will comply with set obligations if granted a credit license.

To be granted a credit license, you will need to be able to comply with the general conduct obligations under the National Consumer Credit Protection Act 2009 (Cth), and be a 'fit and proper' person to engage in credit activities.

The application fee is determined by reference to a calculation method prescribed in the relevant regulatory guide and information sheets published by ASIC, and the relevant tiered scale. Depending on the calculation and scale, the application fee can range AUD450 to AUD26,250.

ASIC aims to decide whether to grant a credit licence within 60 days. However, the time required to process an application is dependent on the nature of the application, and the supporting documents required to be provided to ASIC.

**Australian Transaction Reports and Analysis Centre**

The Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth) imposes legal obligations on certain financial services providers, including the obligation to register with the Austrac if providing designated services, such as deposit-taking, currency exchange, loan, life insurance, securities and derivatives market services.

To register an entity with Austrac, the entity must complete and lodge an Austrac business profile form.

*Last modified 3 Dec 2019*

**What are the main ongoing compliance requirements?**

**Australian Financial Services (AFS)**

AFS Licenses carry a range of financial solvency and risk management requirements. Current general obligations include, but are not limited to:

- ensuring the financial services covered by the license are provided honestly and fairly;
- ensuring adequate arrangements are in place for managing conflicts of interests;
- complying with financial services laws and conditions of the license;
- employing adequate resources (e.g. financial, technological and human resources) to carry out the services covered by the license;
- maintaining the skills and competence to provide the financial services covered by the license;
- employing a dispute resolution and risk management system; and
- ensuring employees are adequately trained and competent to provide the financial services.

The time and resources required for a new license and to maintain ongoing compliance with an AFS License can be significant depending on the required AFS License authorizations. Some of the more time-consuming requirements concern the preparation of licensing proofs on topics such as risk management, compliance, information technology processes and capabilities.
AFS licensees are required to notify ASIC of any 'significant' breach (or likely breach) of their obligations or financial services laws as soon as practically possible, and in any event within ten business days of becoming aware of the significant breach (or likely breach). Failure to report a significant breach is an offence and may result in penalties.

**Australian Prudential and Regulation Authority**

APRA requires all ADIs to comply with its prudential requirements relating to governance, audit, risk management and capital adequacy from the commencement of their banking operations.

APRA's current prudential requirements include but are not limited to:

- maintaining sufficient capital adequacy (namely the prudential capital ratio (PCR));
- ensuring substantial shareholders are 'fit and proper' in the sense that they are financially sound;
- ensuring persons who hold key positions within the ADI are 'fit and proper';
- providing evidence of adequate risk management and internal control systems, business continuity management and information security standards;
- providing evidence of adequate compliance systems and processes;
- employing accounting systems that maintain secure, up-to-date records of all transactions and commitments undertaken by the ADI; and
- engaging in adequate internal and external audit procedures and arrangements.

If APRA authorizes an entity to be deemed an 'authorized deposit-taking institution' this does not automatically allow the ADI to refer to itself as a 'bank' unless special provision has been made. APRA will generally permit an ADI to refer to itself as a ‘bank’ in its trading name and advertising if the ADI holds at least AUD50 million in Tier 1 capital.

Depending on the nature of the breach, if an APRA-regulated institution becomes aware that it has breached (or will breach) a prudential requirement and that breach is 'significant', a breach of a prudential requirement must be reported immediately, or within 10 business days after the institution becomes aware a breach has occurred. Failure to report such a breach is an offence and may result in penalties.

A corporation may also be required to register with APRA as a registered financial corporation under the Financial Sector (Collection of Data) Act 2001 (Cth). In general, this Act applies to any corporation which engages in the provision of finance in the course of carrying on business in Australia. Provision of finance includes but is not limited to:

- the lending of money, with or without security;
- carrying out of activities, whether directly or indirectly, that result in the funding of originating loans or other financing;
- the supplying of goods by way of hire-purchase;
- purchase of debentures or other securities (other than shares) issued by a corporation; and
- acquisition of debts due to another person.

Intra-group financing activity between corporations that are related to one another does not constitute provision of finance.

There are some exemptions, including that this Act does not apply to corporations whose:

- sum of assets in Australia, consisting of debts due to the corporation resulting from transactions entered into in the course of the provision of finance by the corporation, does not exceed AUD50 million in aggregate value; and
- sum of the values of the principal amounts outstanding on loans or other financing, as entered into in a financial year, does not exceed AUD50 million in aggregate value.

Under this Act, APRA collects data from registered financial corporations. Corporations may be required to submit the appropriate forms on a monthly or quarterly basis, as confirmed by APRA upon registration.

_Last modified 3 Dec 2019_
What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized, licensed or exempt, commits a criminal offence and may be liable to imprisonment.

For example, engaging in financial services without an Australian Financial Services license, attracts a criminal penalty under the Corporations Act 2001 (Cth) of five years’ imprisonment, and, in the case of a body corporate, a maximum 6,000 penalty units (having a monetary value of AUD1.26 million). The court may also declare a maximum pecuniary civil penalty.

A person who engages in consumer credit activity without an Australian Credit License is, in the case of a body corporate, subject to a civil penalty of up to 5,000 penalty units (having a monetary value of AUD1.05 million) and a criminal penalty fine of up to AUD504,000, or in the case of an individual, two years’ imprisonment.

If a corporation should be registered with APRA as a registrable financial corporation, and fails to provide APRA with the relevant documents within 60 days of becoming a corporation that should be registered with APRA, the corporation is subject to a fine of 50 penalty units (having a monetary value of AUD10,500) for every day that it does not comply with the reporting requirements.

Regulated activities

What finance and investment activities require authorization?

Generally

To carry on banking business an entity must be authorized by APRA to be an ADI.

All financial activity requires regulatory authorization by ASIC when it is carried on by way of financial services or consumer credit business in Australia.

The following activities are likely to require authorization, if they have sufficient connection with Australia:

- providing financial services, such as advice and dealing in respect of financial products, investment products, non-cash payment facilities, arrangements for the management of financial risk, derivatives, shares and managed investment schemes;
- engaging in Australian financial securities activities, such as arranging and underwriting services in ‘financial products’ in the wholesale markets;
- providing deposit-taking services, such as accepting deposits; and
- engaging in consumer credit activities, relating to consumer leases, consumer credit contracts, credit assistance and securing payment obligations.

Financial Sector (Shareholdings) Act 1998

Acquisitions of shareholdings are covered by the Financial Sector (Shareholdings) Act 1998 (Cth) (FSSA). The FSSA restricts individual shareholdings in financial sector companies to a 20% stake. A financial sector companies is:

- an authorised deposit-taking institution; or
- an authorised insurance company; or
- a holding company of an authorised deposit-taking institution or an authorised insurance company.

The Treasurer may approve a higher percentage stake limit if it is in the national interest to do so or the person is a fit and proper person and the company is new or recently establish, with assets below a certain threshold amount.

If a person obtains practical control of the Australian company, as declared by the Treasurer, then steps will need to be taken to end the practical control.
Foreign Investment Policy

The Australian government's regulation of foreign investment has two main aspects. The first is the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA) and the regulations made under FATA. The second consists of various ministerial statements and policy guidelines issued from time to time.

The Treasurer, assisted by the Foreign Investment Review Board (FIRB), administers this regulation. The Australian government has the power to block notifiable proposals determined to be contrary to the national interest or may impose conditions on an approval.

FIRB is a non-statutory body to advise the Treasurer and the Australian government on Australia's foreign investment policy and its administration. FIRB examines foreign investment proposals and advises the Treasurer whether or not they comply with the policy. It also generally advises the Australian government on foreign investment matters and can assist foreign investors to ensure their proposals (and their associates) conform with government policy.

For business acquisitions, foreign persons should obtain approval for the acquisition of:

- a substantial interest in an Australian corporation or in an offshore company having Australian assets; or
- control of an Australian business, the value of which exceeds the prescribed limits.

A substantial interest exists if the foreign person (and any associates) has 20% or more or several foreign persons (and any associates) have 40% or more of the share capital or voting power in the corporation. Different thresholds apply for designated sectors such as agribusiness.

Foreign persons will require approval for the acquisition of interests in certain types of Australia real estate, depending on its value.

All foreign government investors must obtain approval before making a direct investment in Australia, starting a new business or acquiring interests in land regardless of the value of those acquisitions. Foreign government investors includes bodies politic, entities in which foreign governments or their agencies and related entities have an interest of 20% or more (or such entities from more than one foreign country having an aggregate interest of 40% or more) and entities that are controlled by foreign governments or their agencies or related entities.

Notification and approval of foreign investment will differ depending on the type of transaction and the type of investor (ie. private sector or foreign government investor). Applications are typically considered within 30 days and a further 10 days to notify the applicant, however this period may be extended, and in the case of the Treasurer making an interim order, by up to a further 90 days.

Are there any possible exemptions?

ASIC, APRA and the ACCC have the power to grant a large variety of exemptions in relation to authorisation and licensing requirements.

ASIC may exempt an individual or entity from the requirement to hold an Australian Financial Services license under the Corporations Act 2001 (Cth). For example, product providers are not required to hold an Australian Financial Services (AFS) license when providing general financial product advice on their own products. It must be noted that when an individual or entity relies on this exemption they must disclose to the recipient that the provider does not hold an AFS license. There are a wide variety of other exemptions that may apply.

APRA has the power to grant exemptions to certain institutions (such as charitable, religious and other registered entities) to engage in “banking business” without violating the Banking Act 1959 (Cth).

The ACCC may exempt an individual or entity from the requirement to hold a Credit License under the National Consumer Credit Protection Act 2009 (Cth). For example, a public body or authority constituted under legislation, is not required to hold a credit license for any credit activities they engage in.

Do any exchange controls or other restrictions on payments apply?

Generally, banks are authorized to deal in foreign exchange and can operate foreign currency accounts. The RBA maintains general
oversight of dealers in the foreign exchange market and sets conditions and prudential standards, but does not impose general restrictions on the import and export of funds in and out of Australia.

The flow of currency into and out of Australia is monitored through a reporting system. Under this system, designated cash dealers and individuals are required to report significant transactions – those involving AUD10,000 (other than the foreign currency equivalent) or more – to Austrac. This report is due within 10 business days after the date of the transaction.

The RBA’s express approval may be required to complete some foreign exchange transactions that are real-time gross settlement (RTGS) systems (being RITS, Austraclear and CHESS) and multilateral netting arrangements. For example, the RBA has restricted foreign exchange transactions with governments and nationals of countries subject to United Nations sanctions.

There may also be anti-money laundering and tax considerations to take into account.

What are the rules around financial promotions?

Chapter 7 of the Corporations Act 2001 (Cth) outlines various criteria which must be met when issuing promotional material relating to financial products and financial services. The Australian Securities and Investments Commission Act 2001 (Cth) also prescribes other requirements such as consumer protection provisions.

Any promotional material relating to financial products must not include the use of restricted titles, words or expressions unless strict criteria are met, or the scope of an Australian financial services license permits the provider to do so. For retail clients, advertising materials for financial products are often required to specify the issuer and seller of the product, and inform the client to consider the Product Disclosure Statement (PDS) when making a decision about the financial product.

In addition, tax promoter penalty laws prohibit the promotion of tax avoidance schemes and schemes implemented directly to the way it has been described in a tax product ruling approved by the ATO.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The type of legal entity used to undertake financial or investment activity in Australia will to a degree depend on the nature of that investment or activity.

COMPANIES

A company is a separate legal entity capable of holding assets and being sued in its own name. The most common types of companies are proprietary companies limited by shares (denoted by ‘Proprietary Limited’ or ‘Pty Ltd’ appearing at the end of the company’s name) and public companies limited by shares (denoted by ‘Limited’ or ‘Ltd’).

A key advantage of undertaking financial or investment activity through a company limited by shares is that the liability of the shareholders for the company’s liabilities is limited to the company’s assets and unpaid share capital.

A public company may also be listed on the Australian Securities Exchange, subject to compliance with additional regulatory requirements that apply to listed entities.

PARTNERSHIPS

Partnerships involve two or more individuals or companies carrying on a business, generally pursuant to a partnership agreement. Most partnerships are limited to no more than 20 partners, unless the partnership applies to a particular profession (e.g. an accountancy
practice). A partnership is not a separate legal entity. Its partners are jointly and severally liable for the partnership's liabilities. In certain states limited liability partnerships can be registered with State regulatory authorities. An incorporated limited partnership is a special kind of limited partnership. Limited partnerships are far less common than ordinary partnerships.

JOINT VENTURES

A joint venture is usually a contractual arrangement entered into by two or more parties to carry out a specific commercial endeavour. A joint venture may be incorporated or unincorporated. An incorporated joint venture operates through a company, which is a separate legal entity. An unincorporated joint venture is a purely contractual arrangement between the joint venturers, and they will directly engage in the activities of the joint venture.

TRUSTS

A trust is an arrangement where one person, the trustee, holds property for the benefit of another person, the beneficiary. The trustee holds legal title to the property and must deal with the property for the benefit of the beneficiary. The trustee may be an individual or a company. The trustee is liable for any obligations it incurs as trustee, but it generally has a right to be indemnified out of the trust property.

Common types of trusts are discretionary trusts, unit trusts and bare trusts. The trustee of a discretionary trust may determine which of the beneficiaries are to receive distributions from the trust. The beneficiaries of a unit trust hold units in the trust and their respective entitlements to distributions from the trust is are determined by the number and class of units held. The trustee of a bare trust simply holds the property without having any active duties in relation to it, except to convey the property on demand to the beneficiaries or to deal with the property as they direct.

Funds

An Australian hedge or debt fund is usually structured as a unit trust and would ordinarily fall within the definition of a 'managed investment scheme' in the Corporations Act 2001 (Cth). That Act imposes a wide range of obligations and requirements on the operators of managed investment schemes. Managed investment schemes are regulated by the ASIC. Managed investment schemes may also qualify for tax concessions if they qualify as a "managed investment trust" under Australian tax laws.

Last modified 3 Dec 2019

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

Foreign companies wishing to carry on business in Australia through a branch need to register as a foreign company with ASIC. To apply, a company must lodge an application form with ASIC, along with certified copies of the company's certificate of registration and constituent documents.

To be registered, the foreign company must have a registered office in Australia and a local agent to act on its behalf.

Registered foreign companies are required to lodge annual financial statements with ASIC and comply with certain notice obligations. The local agent will be responsible for acts, matters and things that the company is required to do under the Corporations Act 2001 (Cth) and may be held personally liable for any penalties imposed should a company contravene the Corporations Act 2001 (Cth).

Australia is in the process of transitioning to a new licensing framework for foreign financial service providers with Australian wholesale clients. ASIC has issued Consultation Paper 301: Foreign financial service providers (June 2018) and Consultation Paper 315: Foreign financial service providers: Further consultation (July 2019). The new regime is expected to commence on 1 April 2020, alongside transitional arrangements.

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FinTech
FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

Australia has seen substantial growth in active FinTech businesses in sectors such as lending (including peer-to-peer (P2P) and marketplace lending), personal and business finance and payment management. There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes P2P-type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or increasingly rather than, individual investors on a traditional P2P basis.

ISSUES FOR START-UP MARKETPLACE LENDERS

Following the initial incorporation and start-up funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the start-up lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through an SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable
WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

The ATO has published guidance setting out its views that trading cryptocurrencies are generally subject to Australia’s capital gains tax and the use of cryptocurrencies in businesses may give rise to Australian goods and services tax implications.
Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

ASIC is the financial services regulator in Australia.

GENERAL

To conduct a financial services business in Australia, businesses must hold an AFSL issued by the ASIC. Most FinTech services are captured in the definition of financial services and financial products in the Corporations Act 2001 (Cth) and unless an exemption applies, FinTech companies will require an AFSL. There are limited statutory exemptions available to foreign entities who conduct financial services in Australia.

Additionally, an Australian credit license (ACL) issued by ASIC is required for a business engaging in consumer credit activities in Australia which are captured in the National Consumer Credit Protection Act 2009 (Cth), unless an ASIC exemption applies.

NATIONAL INNOVATION AND SCIENCE AGENDA

In December 2015, the Australian Government introduced the National Innovation and Science Agenda (NISA) to facilitate the development of FinTech. NISA, among other things:

- encourages investment in FinTech companies through tax incentives for early-stage investment;
- enables crowdsourced equity funding of public companies (described further below); and
- establishes the FinTech Advisory Group to advise the Treasurer and the ASIC Innovation Hub.

The ASIC Innovation Hub assists FinTech startup companies to navigate the Australian financial regulatory system by engaging with FinTech businesses and providing information to streamline the licensing process.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

The New Payments Platform (NPP) is an industry initiative to develop a new national infrastructure for fast, versatile, data-rich payments in Australia between financial institutions and their customers. The NPP will connect to all financial institutions and, as a result, to businesses and consumers, allowing funds to be accessible almost immediately upon receipt of a payment.

PEER-TO-PER LENDERS

Peer-to-peer lending involves a financial service provider (the lending platform) acting as the intermediary between investors and borrowers. Lending platforms are generally set up as managed investment schemes, meaning the platform operator must have an AFSL that allows them to run the scheme. Accordingly, these transactions will be caught by the Corporations Act 2001 (Cth) and must comply with the regulatory regime.

Where the borrower is an individual and not a business, the loan will be a consumer credit contract and the platform operator will be required to comply with the National Consumer Credit Protection Act 2009 (Cth), in addition to holding an AFSL.

Regulation of payment services

THE RESERVE BANK OF AUSTRALIA

RBA is responsible for the designation and regulation of systems facilitating the transfer of funds in Australia under the Payment Systems (Regulation) Act 1998 (Cth) and the Payment Systems and Netting Act 1998 (Cth). The RBA has established the Payment Systems Board to take responsibility for the payments system policy. The powers of the RBA include designating a payment system as being subject to regulation, imposing an access regime to establish rules of participation in a payment system and setting standards for payment systems to promote safety and efficiency.
To this end, the RBA has established a number of standards for compliance and access regimes applicable to participants in payment systems.

**EPAYMENTS CODE**

Consumer electronic payment transactions in Australia are regulated by the ePayments Code, administered by ASIC. The ePayments Code applies to voluntary subscribers, including banks, credit unions and building societies.

The Code, among other things:

- requires subscribers to give consumers clear and unambiguous terms and conditions;
- stipulates how terms and conditions changes (such as fee increases), receipts and statements need to be made;
- sets out the rules for determining who pays for unauthorized transactions; and
- establishes a regime for recovering mistaken internet payments.

**Application of data protection and consumer laws**

The Privacy Act 1988 (Cth) regulates the use of personal data within Australia. Where a FinTech business provides credit or handles information relevant to credit, the Privacy Act will apply. The Australian Privacy Principles that are set out in the Privacy Act outline the obligations on the collection, use, disclosure and management of personal information. Where a business undertakes an act outside Australia and there is some link to an Australian citizen or organization, or where it carries out business in Australia, the Privacy Act will apply.

The Office of the Australian Information Commissioner (OAIC) is the body responsible for administering the Privacy Act and has the power to investigate non-compliance.

**Money laundering regulations**

The Anti-money Laundering and Counter-terrorism Financing Act 2006 (Cth) establishes a regime to target and deter money laundering and terrorism financing in designated services. Where a FinTech company provides a designated financial service, such as lending or issuing or selling interests in managed investment schemes, they will become a reporting entity and have obligations under the Anti-money Laundering and Counter-terrorism Financing Act 2006 (Cth). These obligations include compliance reporting and conducting due diligence on customers prior to engaging in any financial services.

**Licensing exemption for FinTech testing**

ASIC has implemented a FinTech licensing exemption, to facilitate the testing of new FinTech services before requiring a business or start-up to obtain an AFSL or ACL. Based on the regulatory guide published by ASIC, allowing FinTech businesses to test their new products and services before they obtain a license can help alleviate the barriers to innovation (including access to capital and speed to market) by:

- allowing concepts to be validated and refined before businesses spend the time and money associated with obtaining a license; and
- providing increased opportunities for businesses to obtain investment that may assist with meeting the costs of complying with the law.

Three components are necessary in this regard:

- existing flexibility in the regulatory framework or exemptions provided by the law which means that a license is not required;
- tailored, individual licensing exemptions granted by the ASIC to a particular business to facilitate product or service testing (individual exemptions of this nature are similar to the regulatory sandbox frameworks established by financial services regulators in other jurisdictions); and
- ASIC’s ‘FinTech licensing exemption’ – provided under ASIC Corporations (Concept Validation Licensing Exemption) Instrument 2016/1175 and ASIC Credit (Concept Validation Licensing Exemption) Instrument 2016/1176, which apply to certain products or
services (FinTech Exemption).

Under the FinTech exemption, a business may, without needing to hold an AFSL, give financial product advice in relation to (or deal in) the following products:

- listed or quoted Australian securities;
- debentures, stocks or bonds issued or proposed to be issued by the Australian Government;
- simple managed investment schemes;
- deposit products;
- some kinds of general insurance products; and
- payment products issued by Australian banks.

Initial Coin Offerings

The ASIC is due to release guidelines in relation to Initial Coin Offerings (ICOs) (which have not been released to date). It is expected that the ASIC will follow the lead of the US, Canada and Hong Kong regulators by including the fundraising method within the regulatory framework governing Initial Public Offerings. The ASIC is reportedly working with advocates in the startup community (including FinTech Australia), to develop guidelines although it is expected that the ASIC may take the view that many of the 'tokens' currently being issued through ICOs would fall within ASIC definitions of 'securities'.

Crowdfunding in Australia

Australia's previous regulatory requirements generally created a barrier to widespread use of crowdsourced equity funding. However changes are underway to make it easier and less expensive for businesses, including start-ups, to raise equity from the general public up to A$5 million in any 12-month period, while ensuring adequate investor protection. However, the Australian Parliament has enacted the Corporations Amendment (Crowd-sourced Funding) Act 2017 (Cth), which will allow eligible Australian businesses (including start-ups) to access crowdsourced equity investments through a licensed online portal.

For companies to access the benefits of the new crowdsourced funding regime, providers of crowdsourced funding services must hold an AFSL issued by ASIC. ASIC accepts applications from potential crowdsourced funding intermediaries for AFSL authorizations to provide crowdfunding services.

The following general restrictions apply:

- Individuals seeking to invest using a crowdsourced funding platform can contribute up to AUD10,000 per year, per company.
- Crowdsourced funding will also be available to Australian public companies with turnover/gross assets less than AUD25 million.
- Proprietary companies will be subject to additional governance and reporting requirements (including the provision of annual financial reports to shareholders).

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.
The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Equitise and Pozible. Significant changes have recently been made in the Australian regulatory landscape to make crowdfunding more accessible. (For further information, please see FinTech products and uses – particular rules.)

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

There are various incubators or accelerators in the Australia market which offer support, facilities and funding for startups, often in return for an equity stake.

Venture capital and debt

Venture capital (VC) funding is a type of equity investment usually targeted at early-stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions. Australian VC funds include Blackbird Ventures, Carthona Capital, Our Innovation Fund and Squarepeg Capital.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund, examples of which includes Reinventure, NAB Ventures and Telstra Ventures. The benefit of having a CVC as an investor for a FinTech start-up is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element (i.e. a warrant) allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through VC. At the time of writing, venture debt is increasingly a source of funding in the Australian market with about 5 regular providers of venture debt locally. However, the venture debt industry is still nascent as compared to the United States.

Warehouse and platform funding

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to an SPV. The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

One recent example of warehouse financing involves Zip Money Limited, a listed Australian non-bank consumer financier, which involved a two-year asset-backed securitization warehouse in relation to its consumer receivables loan book.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Australia has both debt and equity capital markets which are accessible to businesses (usually of a certain size).
Raising finance by way of an Initial Public Offering (IPO) is a popular funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the Australian Securities Exchange.

**CONVERTIBLE BONDS/LOAN NOTES**

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

**Initial Coin Offerings**

An Initial Coin Offering (ICO) is an alternative to a share market IPO, crowdfunding or venture capital funding round for a startup with a blockchain-based platform or project. A startup looking to undertake an ICO will first produce a 'white paper' and then market itself to potential investors, much in the same way as a company undertaking an IPO.

ICOs are not common in Australia however there is a growing demand for this method of fundraising in Australia, particularly for startups with blockchain-based platforms that are looking to raise money fast.

In late 2017, Perth-based blockchain energy start-up Power Ledger become the first Australian company to undertake an ICO – raising AUD17 million in three days.

It is likely that, in most circumstances, Australian ICOs will involve the issue of securities and therefore fall under existing regulations for the offer of securities. This means ICOs will be subject to the same reporting obligations and regulations as an IPO.

**Incentives and reliefs**

**INCENTIVES FOR EARLY STAGE INNOVATION START UPS**

Incentives are available for startups (known as 'Early Stage Innovation Companies') which:

- are less than three years' old;
- have income less than AUD200,000 and expenses less than AUD1 million; and
- have businesses that are eligible (meaning that they have scalability, potential for growth and are undertaking research and development (R&D)).

Investments (less than 30% of the equity in an Early Stage Innovation Company) would generally qualify for a 20% non-refundable tax offset (capped at AUD200,000 per investor) and a ten-year exemption to capital gains tax.

**ELIGIBLE VENTURE CAPITAL LIMITED PARTNERSHIPS**

Investment funds investing into FinTech growth companies may be structured as venture capital limited partnerships (VCLPs) or early stage venture capital limited partnerships (ESVCLPs) to receive favorable tax treatment for the funds limited partners and with regard to carried interest payable to the funds general partner. For VCLPs, benefits include tax exemptions for foreign investors (eligible foreign limited partners) from capital gains tax on their share of any profits made by the partnership. For ESVCLPs, an income tax exemption applies to both resident and non-resident investors, plus a 10% non-refundable tax offset is available for new capital invested.

**FINTECH INCENTIVES**

The R&D Tax Incentive program is available for entities incurring eligible expenditure on R&D activities, including certain software R&D activities commonly conducted by FinTech/tech-growth companies. Claimants under the R&D Tax Incentive may be eligible for:

- **small businesses (< AUD20 million aggregated turnover)** – 43.5% refundable tax offset of the first AUD100 million of eligible R&D expenditure, and
- **other businesses** – a 38.5% non-refundable tax offset.

Generally, eligible R&D activities include experimental activities whose outcome cannot be known in advance and are undertaken for the purposes of acquiring new knowledge (known as 'core R&D activities'), and supporting activities directly related to core R&D activities (known as 'supporting R&D activities').
Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common in Australia.

A loan may be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are novation, assignment and sub-participation, as described below.

NOVATION

A novation is a full legal transfer of the party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee. It results in a fresh contract being formed between the continuing party and the transferee, with the transferor being released from its obligations.

Assignment

An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, an assignment may occur without the debtor's consent. An assignment may be effected as either an equitable assignment or legal assignment, depending on whether certain statutory requirements have been satisfied.

Sub-participation

A sub-participation is a transfer of the economic interest in a loan without the legal relationship between the existing parties changing. Sub-participations involve the buyer taking on double credit risk, on both the borrower and the seller.

TRANSFER MECHANICS

The facility agreement and the security trust deed will usually include transfer mechanics. These will specify the way in which the rights and obligations of an existing lender are novated or assigned to a transferee lender and any conditions that may apply, such as consents or restrictions on the nature of the transferee. The loan transfer itself is commonly based on the Loan Market Association recommended form documents made available by the Asia Pacific Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement will usually be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

Where security interests are transferred, registration may be required either on the Personal Property Securities Register or elsewhere (depending on the nature of the asset).

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often considered in the due diligence undertaken by the seller's legal advisors. Some of the key issues are:

- **Confidentiality**: whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **Data protection**: whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser (in particular, the Privacy Act 1988 (Cth) and the National Credit Code should be considered);
Lender eligibility - whether there are any restrictions considering the type of entity to which the loan may be transferred;

Undrawn commitments: whether there are any continuing obligations for further funding or other material obligations of the lender that may bind the transferee or reduce claims made by the transferee;

Transfer mechanics: whether there are any steps that need to be taken to transfer the loan in accordance with its terms;

Consent: whether a transfer requires the consent of, or notification to, any other parties; and

Voidable transactions: if the seller is insolvent, whether certain transactions may be declared voidable under the Corporations Act 2001 (Cth).

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in Australia varies according to the asset class. The main asset classes are usually considered to be:

- social infrastructure assets including:
  - health (hospitals and medical centers);
  - education (schools, childcare and universities);
  - social accommodation (social housing and retirement villages); and
  - community (court houses, fire stations and prisons); and
- economic infrastructure assets, including:
  - regulated utilities such as water companies;
  - transport assets such as roads and airports; and
  - telecommunication assets such as mobile phone towers.

Key sectors are considered below.

Energy

The gas and electricity industries in Australia are regulated by the states and territories.

ELECTRICITY

There is a mix of both government-owned and privately owned electricity distribution and retail businesses in Australia, with a trend towards privately owned utilities in all states and territories.

The majority of states and territories have combined to form an interconnected National Electricity Market (NEM), being Queensland (QLD), New South Wales (NSW), the Australian Capital Territory (ACT), Victoria (VIC), South Australia (SA) and Tasmania (TAS). The NEM is a wholesale electricity market for the supply and purchase of electricity across those interconnected states and territories and it is currently under construction with anticipated completion in 2021. Western Australia (WA) and the Northern Territory (NT) do not participate in the NEM and have their own major networks. The Australian Energy Market Operator (AEMO), an independent corporate body established by the Australian government, administers and operates the NEM.
There is only one major electricity transmission and distribution network in each of the ACT, SA and TAS. While there are multiple networks in QLD, NSW and VIC, each is a monopoly provider in a particular area. For example, Ausgrid, Endeavour Energy and Essential Energy operate monopolies in NSW. The distribution and transmission sectors are not generally integrated, although there is some common ownership in the distribution and retailing sectors in TAS and the ACT.

**GAS**

AEMO operates the wholesale and retail gas markets of eastern and southern Australia and oversees the gas transmission network in VIC.

In addition, AEMO is responsible for national transmission planning and the operation of the Short-Term Trading Market (STTM) for gas. The STTM is a market-based wholesale gas balancing mechanism that has been established at defined gas hubs in NSW, QLD and SA. The STTM facilitates the short-term trading of gas between pipeline owners/operators, shippers and gas producers. VIC does not participate in the STTM, and has established its own wholesale gas market which producers, transporters, retailers and end users all engage in.

**Telecoms infrastructure**

The telecommunications networks (fixed and mobile) in Australia are predominantly privately owned by a number of service providers.

Telstra, a wholly privatized company offering a full range of telecom services, is Australia’s largest telecommunications provider and dominates ownership of the fixed-line network. Control of the wireless telecommunications sector is predominantly shared between three privately owned service providers, Telstra, Optus and Vodafone.

The Commonwealth Government is currently investing in fiber-optic, fixed wireless and satellite infrastructure to develop, construct and deliver Australia’s first national wholesale only, open access broadband network (the National Broadband Network, or NBN) through a government-owned entity which is classed as a government business enterprise, NBN Co Limited. The new infrastructure will replace the existing broadband infrastructure, aiming to create quicker and more consistent broadband service and provide opportunities for development of improved asset management systems. The regulatory framework for the NBN provides that the Australian Government will retain full ownership of NBN Co until the national broadband network rollout is complete, which is anticipated to be in 2021.

**Transport infrastructure**

Public transport networks in Australia are predominantly government-owned and operated, across the three levels of government – federal, state and local, with certain exceptions where networks have been franchised, privatized or governments have entered into public-private partnerships.

**RAIL**

Typically, the infrastructure and assets for rail networks in Australia are owned by state governments or the federal government. The operation of trains in Australia is commonly franchised by the government and outsourced to the private sector. The passenger networks in each state and territory are typically owned by government entities. The railway infrastructure in QLD, TAS, VIC (for non-interstate lines), SA (for non-interstate lines) and the NT are integrated. The mainland interstate track is, for all states and territories except the NT and TAS, owned, leased, maintained and controlled by a federal government owned corporation (the Australian Rail Track Corporation), however, the interstate freight operations in Australia are wholly commercial, being privately owned and operated.

**ROADS, BRIDGES AND TUNNELS**

The operation, maintenance and improvement of roads in Australia is largely the responsibility of local governments, with the exception of the arterial road network and most local roads in unincorporated areas which are the responsibility of the state and territory governments. The federal government also shares responsibility with the states and territories for a defined national network of road transport corridors and rail-road inter-modal connections. The delivery, operation and maintenance of such infrastructure is often outsourced to the private sector. For example, management of toll-roads (including the design, build, financing, operation, maintenance and collection of tolls) is typically outsourced to the private sector on a full concession basis, with the states and territories holding the perpetual lease over toll road land.

**AVIATION**

Aviation infrastructure in Australia is typically government-owned. All federal airports are located on government-owned land and are under long-term leases to private entities. There are significant restrictions on ownership of airport-operating companies under the
Airports Act 1996 (Cth), including a 49% limit on foreign ownership, a 5% limit on airline ownership and a 15% limit on cross-ownership between paired airport operator companies. The majority of all other Australian airports are owned and operated by local government authorities, with a small number operated by the private sector on the government's behalf, or both owned and operated by the private sector for public use. The aviation regulator in Australia is the Civil Aviation Safety Authority (CASA). The government has influenced market structures to combat competition issues, for instance prohibiting the cross-ownership of airports.

**MARITIME AND PORTS**

The ports in Australia are typically owned by the state and territory governments, however, the operation of, and investment in ports is largely privatized, with port assets typically privatized on a long-term lease basis.

Infrastructure Australia, a government body, oversees rail, road, airports and other infrastructure at a national level.

**Other infrastructure**

**WATER**

State and local governments are typically responsible for the ownership of infrastructure and delivery of water services in Australia, generally through government-owned companies. The operation and management of water in SA has been privatized, and local utilities in VIC have been largely privatized. Water utilities are regulated across the states and territories by the relevant State authorities.

**DEFENSE**

Typically, defense assets are owned by the public sector.

**EDUCATION**

The education sector in Australia consists of both public and private institutions. Governance and management of education is split between the three levels of government. For instance, the majority of universities operate under State and territory laws and regulations, while early child education facilities operate under the guise of local governments. The Australian Government's Department of Education has the primary responsibility of distributing funding and developing policy in regards to childhood education, higher education, vocational education and training, international education and research.

**WASTE**

The waste management systems in Australia are the responsibility of state, territory and local governments. The sector is a mix of both public and private operations. The Australian Government is responsible for waste management policy. The private and public sector are involved in all forms of the waste management process.

**Are there special rules for investing in energy and infrastructure?**

**Generally**

Energy and infrastructure markets in Australia, similar to other developed nations, operate in a heavily regulated environment. There is no specific regime governing or restricting investment in energy or infrastructure in Australia over and above existing regulation for investors and funders more generally. When making an investment, the legal and regulatory position relevant to the underlying project must be considered. For example, a project relating to a hospital will require various environmental and planning approvals, consents, building and operating permits, and work-health and safety accreditations.

**AUSTRALIAN COMPETITION AND CONSUMER COMMISSION**

The ACCC regulates a range of infrastructure services, such as energy, communications, water and smaller markets with limited competition. While the ACCC acts as an overarching regulator, investors, owners and operators must also comply with both State and industry-specific regulation. The ACCC facilitates the National Access Regime, which encourages third party access to nationally significant infrastructure services. The ACCC assesses access undertakings lodged by the owners or providers of infrastructure services.
FOREIGN INVESTMENT REVIEW BOARD

All foreign investment proposals in Australia above certain thresholds, determined on a case-by-case basis, are reviewed by the FIRB to ensure such investments are not contrary to the national interest. Notification and approval of foreign investment will differ depending on the type of transaction (i.e. telecommunications or energy transaction), or the type of investor (i.e. private sector or foreign government investor).

FIRB aims to provide a decision within 30 days of being notified. Once formally notified, the Treasurer has 30 days to make a decision and a further 10 days to notify the parties concerned of the outcome. If these timeframes are not met, the Australian Government loses the ability to block the proposal or impose conditions on it. The government may, however, extend the process by up to 90 days by issuing an interim order.

Key sector-specific issues are flagged in the sections below.

Energy

The energy markets in Australia have a complex system of arrangements between suppliers, generators, transmission and distribution which are moderately regulated. Regulation and market oversight of the energy sector is split between the Australian Energy Regulator (AER) (for all states other than WA) and the Australian Energy Market Commission (AEMC).

The National Energy Retail Laws and National Energy Retail Rules, establish a national energy customer framework for the regulation of the retail supply of energy (electricity and gas) to customers where the NEM applies. The laws aim to promote retail competition and empower customers to negotiate energy contracts. The NEM operates on a relatively competitive basis, with generation, transmission and retailing assets split in each state and territory. The market operates with streamlined regulations, limited barriers to access, and minimal direct government intervention. In WA and the NT, where the NEM does not apply, energy is regulated by the Economic Regulation Authority (ERA) and the Utilities Commission, respectively.

Under the NEM, an authorization issued by the AER is required prior to engaging in the retail sale of energy, unless an exemption applies. Under state-based authorities, transmission and distribution businesses are required to be issued with a license before providing transmission and distribution services. Applications must be lodged with the state based regulator and an associated fee will apply.

It is important to note certain infrastructure assets are subject to more stringent safeguards on pricing and staffing, in an effort to preserve community expectations. For example, in the recent sale of Ausgrid (in October 2016), the NSW government implemented legislation prescribing the minimum number of employees the buyer would have to maintain until 2020, and the categorization of employee.

Recently, increasing demand for ‘clean’ energy, alongside firm environmental regulation, has presented concern for external investors wishing to invest in Australia’s energy sector. In 2015, the federal government increased Australia’s Renewable Emission Target to 23.5% of Australia’s electricity generation being sourced from renewable sources by 2020. Investors need to understand how environmental and technology changes may impact on the overarching regulatory framework and should consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with license conditions or the granting of specific subsidies.

Telecoms infrastructure

The telecommunications sector in Australia operates in a competitive market, where the regulatory barriers to entry are limited. The telecommunications sector has two main regulators:

- The ACCC which operates under the Competition and Consumer Act 2010 (Cth) prohibits and prevents carriers engaging in anti-competitive conduct, breaching record-keeping rules or breaching access rules.

- The Australian Communication and Media Authority (ACMA) which operates under the Telecommunications Act 1997 (Cth) and has responsibility over technical matters (i.e. carrier licensing, service provider licensing and number portability). The cabling industry is regulated by the Telecommunications Cabling Provider Rules 2014 (Cth) (CPRs).

The ACCC’s access regulation plays a key role in the increase of infrastructure and retail competition in the telecommunications sector. For example, the ACCC assisted opening access to Telstra’s line services, increasing competition in retail and broadband networks. ACCC regulation is commonly higher in areas of insufficient competition, namely transmission routes in regional and outer metropolitan areas.

There are two different types of individuals or entities that may provide telecommunication services to the public – being carriers and carriage service providers (CSPs). Carriers are owners of telecommunications networks unit that supply carriage services to the public. The
ACMA requires carriers to obtain a carrier license and to comply with certain obligations under the license, unless an exemption applies or the authority allows for nominated authority declarations, whereby another party to takes on the responsibilities of a carrier for a network unit. The Minister for Communication also has the authority to impose license condition declarations, whereby further license conditions are imposed on certain classes of carriers. In contrast, a CSP, a person or entity that supplies a carriage service to the public using a network unit (i.e. internet service providers) is not required to hold a carrier license.

Under the CPRs, all cabling work is required to be performed by a registered cabler or under the express direction of a registered cabler. Cablers are required to register with an ACMA-accredited registrar.

**Transport infrastructure**

The National Transport Commission operates under the National Transport Commission Act 2003 (Cth) as an independent advisory body with the aim of enhancing safety, productivity and environmental performance of Australia's transport systems. The body provides impartial advice and reform proposals through the Transport and Infrastructure Council.

**RAIL**

The Office of the National Rail Safety Regulator (ONRSR) is responsible for the implementation of safe rail operations and controls a singular set of rail safety laws in Australia, with each state and territory (except QLD) passing enabling legislation to give effect to the Rail Safety National Law. Rail Transport Operators must obtain a license that certifies the competence and capacity of the operator to manage the risks associated with railway operations. The accreditation is required prior to commencing any railway operations.

**ROADS**

The state and territory governments each have government departments which administer the National Prequalification System for Civil (Road and Bridge) Construction Contracts (NPS). The NPS separately takes into consideration the financial and technical capacity of contractors and identifies prequalification categories for road construction, bridge construction and financial levels (referring to financial stability, solvency and capacity to manage cash flow), against which the NPS assesses the capacity of a contractor to undertake contracts of varying risk and complexity. Austroads is the key organization responsible conducting strategic research on transport developments, provides guidance on the design, construction, management and infrastructure of road networks.

**Other infrastructure**

For most infrastructure assets in the private sector, it is likely that there will be a ‘change of control’ provision requiring the regulator or controlling government to approve the new owner. On publicly-procurred infrastructure, it is quite common for long-term projects to have a ‘change in control’ clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the construction period but this is often relaxed post construction provided any change in control is not to an ‘Unsuitable Third Party’.

*Last modified 3 Dec 2019*

**What is the applicable procurement process?**

In Australia, procurement of infrastructure projects is almost invariably carried out on a contestable tender basis. A contestable tender basis is deemed to be a fair, transparent and competitive way to obtain value for money. Such contestability may be publicly advertised or sought from a formal pre-qualified list of bidders or informally sought from a private list of contractors. Some states do, however, have unsolicited proposal regimes whereby the private sector may directly approach Government with a proposal for infrastructure development and then be awarded the rights on an uncontested basis, but there are strict criteria that apply.

**Investing in energy and infrastructure**

There is no body of public procurement law. Procurement by the state and federal governments is governed by a mixture of policies such as guidelines and codes of practice, statute, regulations and common law.

While private sector procurers of construction services are generally free to set their own ‘rules’ of procurement, they can still be exposed under statute (for example under the Australian Consumer Law) or at common law. Procurers will find themselves exposed to these laws if they either do not follow the process which has been specified in the tender documentation or if they make inaccurate representations.
about the way in which the tender process will be managed or contracts awarded. Conversely, bidders may be exposed to common law process contract challenges if they withdraw during evaluation.

In addition to the infrastructure research and advisory bodies established by some states and the federal government, each government agency has at least one designated department or body which develops and implements policy applicable to procurement of infrastructure projects. In some cases specialized policies will apply to particular types of procurement such as defense, health infrastructure and the delivery of Public-Private Partnerships (PPP) and unsolicited proposals. In addition, government agencies which procure a large amount of infrastructure (for example statutory road management agencies) often have their own internal policies and procedures applicable to the procurement of that work.

For projects with a value in excess of AUD10 million, many government agencies have implemented a system of audits, checks and balances to seek to ensure that the tender and procurement processes are competitive, transparent and compliant with the relevant rules and policies. This means that many government agencies are required (or choose to):

- appoint a probity (fairness and honesty) auditor to audit the tender process for the project;
- engage a probity advisor to provide ongoing advice to the agency in relation to management of the tender and tender queries; and
- participate in periodical reviews (sometimes known as ‘Gateway’ reviews) in order to benchmark, test and check the business case for the project.

**STATUTORY REGULATION OF GOVERNMENT TENDERS**

The Australian Consumer Law (and state based Fair Trading legislation) will prohibit certain kinds of behavior and conduct during the course of a procurement, for example, misleading and deceptive conduct. Bid rigging, cover pricing and certain other collusion between tenderers is prohibited under the Competition and Consumer Act 2010 (Cth).

To avoid the possibility of collusion or corruption, tenderers may be asked to provide a statutory declaration that there has been no collusion in the tender process with other tenderers.

To emphasize the transparent nature of government tendering, many government agencies are often now required by statute or policy to publish detailed information:

- identifying the successful tenderer;
- specifying the tender prices submitted by all tenderers; and
- detailing the nature and form of contract executed in respect of the works;

Additionally, government agencies may be required to disclose information under Freedom of Information legislation or through pre-trial discovery processes.

**POLICIES, GUIDELINES AND CODES OF PRACTICE**

There are numerous policies, guidelines and codes of practice which govern procurement of infrastructure by government agencies at all levels of government. Many government agencies also have specific policies directed at the delivery of projects by different forms of procurement such as a PPP or alliance contracting. In some cases, such as the Commonwealth Procurement Rules issued by the federal government, there are rules dealing specifically with when competition in a tender process may be limited, and additional requirements for procurements at or above a certain threshold.

The core objective of the Commonwealth Procurement Rules is to ensure that value for money is obtained in federal government procurement. The value for money principle requires consideration of all relevant financial and non-financial costs and benefits of each proposal including whole of life costs (such as any maintenance costs or costs in connection with a dispute). The Commonwealth Procurement Rules state that value for money is enhanced in government procurement by:

- encouraging competition and being non-discriminatory;
- promoting the use of resources;
- making decisions in an accountable and transparent manner;
- encouraging appropriate engagement with risk; and
Financing energy and infrastructure

There are three general ways that can be implemented to allow the private sector to assist deliver infrastructure:

- traditional procurement using government financing;
- corporate financing using private financing; and
- project financing using private financing.

PPPs are often perceived as a way to improve or create public infrastructure without hindering on government funds and budget constraints.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Australia (including in relation to PPPs) are as follows.

Funding

Common forms of funding in energy and infrastructure include:

- debt finance, including:
  - loans made on a project finance basis;
  - loans made on a corporate finance basis (balance sheet debt); and
  - mezzanine debt;
- asset sales;
- federal grants;
- value capture;
- concessional loans;
- asset finance or hire-purchase arrangements; and
- subordinated shareholder loans.

PROJECT FINANCE

Generally, project sponsors prefer debt to be secured on a limited-recourse basis. Limited-recourse means that financiers only take security over the assets of the project itself and its outputs (including revenue) rather than any wider assets of the sponsor and its corporate group. This preference is largely driven by the fact that it is only the project’s assets and revenues which are ‘at risk’ of enforcement. This approach enables project sponsors to retain flexibility with respect to their other ventures.

A common structure for project finance involves incorporating a special purpose vehicle for the project (Project Co). The Project Co then enters into a range of documents for the delivery of the project including the project documents (relating to construction and operation of the project) and the finance documents (relating to the financing of the project).

In order to secure this funding, the project needs to stack up from a ‘bankability’ perspective. In essence, bankability is a term used to describe:

- the willingness of financiers to fund the project based on security of cash flows (in and out) of the project; and
- the minimization of any residual risk held by the Project Co receiving the funding.
CORPORATE FINANCE

Debt based on corporate finance facilities may be utilized where a project is not sufficiently bankable to receive limited recourse finance. Such facilities may be made on an aggregated basis so that a variety of smaller projects create a portfolio of assets. Recourse for the financier to security is limited to the security based on that portfolio of assets with all assets being cross-collateralised. Alternatively, such facilities can be full recourse, meaning financiers may have recourse against all assets of the relevant companies within the corporate group of the Project Co.

BONDS

While debt-based bond funding is available for project finance, the Australian bond market:

- currently lacks longer tenor instruments to provide the long-term certainty that is often desired in the infrastructure project finance market; and
- is often considered too small to support the funding needs of Australia’s mega projects.

It is now becoming increasingly common for those seeking bond debt to access the US and Asian bond markets instead.

Investing

Australia’s superannuation funds have been predominate investors and experts in Australia’s infrastructure sector over the past two decades. It is common to see large fund managers or infrastructure investment teams partner with Australian superannuation funds to participate in the infrastructure market. These specialists often compete with overseas investors and entities such as Chinese state owned enterprises.

Common forms of investing in energy and infrastructure include:

- equity investment in special purpose vehicles or entities that may have a portfolio of interests (i.e. share capital); and
- secondary market investment in operational projects.

Standard form documentation may be used when entering into an energy or infrastructure transaction in Australia. Standard forms include:

- Australian Standards (Standards Australia);
- PC-1 1998 (Property Council of Australia);
- Australia Building Industry Contract (Master Builders’ Association and Royal Australian Institute of Architects);
- FIDIC (International Federation of Consulting Engineers); and
- NEC3 (Institution of Civil Engineers)

It is important to note that these contracts are heavily amended and bespoke contracts are often used for alliances, PPPs or hybrid models.

Restructuring

Enforcement and sanctions

*When can there be regulatory investigations?*

ASIC is a key regulator of the financial services industry in Australia. ASIC has the power to conduct a formal investigation when it suspects that a breach of law is being committed or is likely to be committed by:
In conducting such an investigation, ASIC has various compulsory powers including powers to require the production of documents and information, and for individuals to be formally questioned by ASIC.

ASIC also has the power to institute proceedings or seek other remedies for breaches.

Other regulators relevant to financial services businesses include APRA, ATO and ACCC, while Austrac operates as an intelligence gathering agency. Each of these bodies (except Austrac) has similar investigative powers to ASIC; Austrac has slightly more limited powers. All of them can also institute proceedings for contraventions of relevant legislation.

**What regulatory penalties may apply?**

Where a breach of law has occurred, ASIC may take various steps, including obtaining an enforceable undertaking from, or issuing an infringement notice on, the offending party.

An enforceable undertaking may include providing compensation, or outlining a process for independent monitoring of an organization's continuing compliance with the law, while an infringement notice will impose financial penalties on an offending party.

If an infringement notice is not complied with or an enforceable undertaking is breached, ASIC can bring a civil penalty action against the recipient seeking payment of the fine and/or compliance with the terms of the enforceable undertaking. ASIC can also pursue civil penalties and other remedies (e.g. banning individuals from operating in the industry or serving as directors) even without first seeking enforceable undertakings or issuing infringement notices. For serious breaches which involve criminal conduct, it can (working with the Commonwealth Director of Public Prosecutions (CDPP)) pursue criminal charges.

ASIC will always assert the right to make an enforcement outcome public, unless the law requires otherwise.

The other regulators listed above (APRA, ATO, ACCC and Austrac) also have the ability to pursue various types of penalties for breaches of the legislation and rules that they respectively regulate.

**What criminal penalties may apply?**

ASIC can and does pursue criminal charges (working with the CDPP) when it considers the conduct involved warrants it. ASIC will generally only consider criminal action for offences involving serious conduct that is dishonest, intentional or highly reckless, even if a civil remedy is available for the same breach. Such offences include:

- insider trading;
- a breach of statutory duty by a director; and
- market manipulation.

The same is also true for some of the other regulators listed, for example for cartel conduct (the ACCC), or failure to withhold withholding tax or committing a tax fraud or evasion (the ATO), or breaches of reporting requirements under Australia's AML/CTAF legislation (Austrac).

**Current regulatory enforcement outlook**

A major judicial inquiry into the Australian financial services sector held in 2018/2019 has resulted in Australian regulators switching to a 'why not litigate?' stance. This has resulted in regulators proceeding with court proceedings in circumstances where, in the past, they may have sought to reach a negotiated outcome on penalties to be imposed for breaches of non-criminal contraventions of legislation.
Tax

Tax issues

*Are stamp, registration, transfer or other similar taxes applicable?*

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There is no stamp duty, registration, transfer or similar tax payable on the advance of a loan in Australia.

Only one Australian state, Queensland, levies stamp duty (of up to 5.75%) on transfers or assignments of loans. In Queensland, the transfer or assignment may be dutiable where the borrower is located in Queensland or if the loan is secured by a mortgage or charge over property in Queensland.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There is no stamp duty, registration, transfer or similar tax payable on the taking, or issue, of a mortgage, debenture or other security in Australia.

In certain Australian states and territories, the transfer or assignment of a mortgage can potentially trigger stamp duty. Certain exemptions or concessions are available, depending on the relevant jurisdiction. Also, there are potential structuring options (e.g. appointing a security trustee to hold mortgages and other securities) to minimize exposure to stamp duty in respect of an assignment of such securities.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

There is no stamp duty, registration, transfer or similar tax payable on the issue of a debt security in Australia.

As noted above, Queensland is the only Australian state that levies stamp duty on transfers or assignments of loans and other debt instruments. However, the transfer or assignment of corporate bonds are generally exempt from stamp duty in Queensland. There are also exemptions in Queensland in respect of certain securitisation arrangements or debt factoring arrangements.

*Do tax authorities take priority on enforcement?*

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

For federal taxes (e.g. income tax, Goods and Services Tax and Fringe Benefits Tax), the Australian Taxation Office (ATO) generally does not take priority over any secured lenders or debt security holders. However, in certain limited circumstances, the ATO may take priority over secured lenders, for example when:

- a garnishee notice is issued to allow the ATO to recoup from third parties amounts they owe, or may owe, a tax-owing taxpayer; or
- trustees (including administrators, receivers and liquidators) are obliged to retain sufficient monies from the trust fund to pay tax if the relevant assessment has been issued.

However, for certain state taxes (e.g. stamp duties and land tax), the relevant state revenue authority can take priority over secured lenders or debt security holders.

*Last modified 3 Dec 2019*
Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Unless an exemption applies under domestic law or an applicable double tax treaty, where a payment of interest (as broadly defined) is paid (or is deemed to be paid) from Australia to offshore under a loan which is treated as debt for Australian tax purposes, the borrower is required to withhold and pay an amount equal to the applicable withholding tax rate to the ATO.

If so:
What is the rate of withholding?

The current rate of Australian interest withholding tax is 10%.

What are the key exemptions?

The more commonly relied on exemptions include:

- exemptions for a publicly offered syndicated loan facility or a publicly offered debenture issued by an Australian resident company or Australian unit trusts and by a company or unit trusts not resident in Australia but carrying on business at or through permanent establishments in Australia;

- exemptions for certain foreign tax exempt superannuation funds and foreign sovereign entities which do not have control or influence in certain Australian borrowers; and

- reliance on a double tax treaty (for example, an exemption is available for interest paid to government entities or independent financial institutions).

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes, the analysis described above is generally applicable to both interest payments under a loan or other form of debt security.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

Generally no.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

Key contacts
Onno Bakker
Partner
DLA Piper Australia
onno.bakker@dlapiper.com
T: +61 2 9286 8260
Austria

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Austrian and EU law.

The admission criteria to be listed on the Official Market and the Second Regulated Market are set out in the Stock Exchange Act 2018 (SEA).

The admission must be:

- submitted in writing by the issuer;
- co-signed by an exchange member; and
- accompanied by:
  - a current excerpt from the companies register;
  - the current company by-laws;
  - the company's compliance guidelines; and
  - an approved prospectus in two counterparts in accordance with SEA, unless an exemption from these rules applies.

For the entire duration of the listing, the issuer's securities must be included in the continuous trading procedure according to the Trading Rules for the Automated Trading System XETRA (Exchange Electronic Trading). The applicable admission criteria and ongoing obligations of the issuer are set out in the prime market and mid-market rules which can be downloaded from the Vienna Stock Exchange website.

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What are common issuing methods and types of debt securities?

The most common types of debt securities issued are bonds such as corporate bonds, government bonds (e.g., notes or treasury bills) and banking bonds (e.g., debt securities, mortgage bonds or medium-term notes). Bonds issued by the public sector, but also increasingly corporate bonds, are the most common forms.

The admission criteria to be listed on the Official Market and the Second Regulated Market are set out in the Stock Exchange Act 1989 (SEA). Bonds that are admitted to listing on the Official Market or Second Regulated Market or admitted to trading in the Third Market include government bonds, federal treasury certificates, treasury notes, interest rate and government strips, corporate bonds, banking
bonds and convertible bonds. The trading platform used is Xetra® with the trading procedure 'Auction Trading' (intra-day auction).

The public sector segment contains all debt securities issued by government bodies or that have a guarantee from the public sector: Austrian federal government bonds, Austrian Treasury bills (ATBs), bonds issued by provincial governments, bonds issued by other states etc.

The segment corporate sector contains bonds, that are issued by companies for the purpose of financing corporate activities (bonds issued by banks are, by definition, not classified as corporate bonds.).

The corporate sector is divided into the corporates prime segment and the corporates standard segment.

The financial sector segment contains debt securities issued by banks and insurance companies. This is the largest segment as measured by the number of issues. Investors have a wide choice of products regarding the security of their investment (asset-backed bank bonds, mortgage-backed bonds and mortgage-backed bonds issued by public bodies, unsecured bonds, junior bonds and unsecured supplementary capital bank bonds) as well as the type of interest (fixed-interest bonds, floating-rate bonds, zero-coupon bonds).

The performance-linked bond segment contains structured bonds whose interest and repayment depend on an underlying instrument. Underlyings may be stock indices, commodities or hedge funds etc. The issuers are usually banks or special purpose vehicles (SPVs). The range of products includes securities with a capital guarantee as well as without a capital guarantee, and reverse convertible notes (cash or share bonds).

What are the differences between offering debt securities to institutional / professional or other investors?

If debt securities are only being issued to professional investors and not to the public, a prospectus is not required.

In some cases, bonds may be issued in the form of registered bonds (Namensschuldverschreibungen) where the bonds are subscribed by insurance companies that allocate the bonds to their reserve fund (Deckungsstock), since a more favorable risk weighing applies to registered bonds under the current regulatory framework (as compared to bearer bonds).

When is it necessary to prepare a prospectus?

In order to list on a regulated market, the preparation of a prospectus will normally be required. However, the Austrian Stock Exchange Act and the Capital Market Act grant the following exemptions from the obligation to publish a prospectus:

- bonds issued by credit institutions from Austria or from European Economic Area (EEA) member states regularly or as tap issues provided the following requirements are met:
  - issuing volume of the bond < EUR75 million;
  - bonds are not subordinated bonds or convertible bonds; and
  - the interest payments and principal payments are not permitted to be contingent on a derivative;
- bonds issued by the Republic of Austria, the Austrian federal states or EEA member states provided the following requirements are met:
  - Official Market – ‘automatic’ admission by law to the Official Market, after submission of the terms and conditions of the bond and of request for admission to listing, the bond may start trading two days later; and
  - Second Regulated Market – admission to listing is possible without a prospectus;
- bonds issued by a public body of an EEA member state:
  - admission for listing to the Official Market and to the Second Regulated Market without a prospectus; and
- bonds guaranteed by the Republic of Austria, by an Austrian federal state, by an EEA member state or by a public body of an EEA.
member state:

- admission for listing to the Official Market and to the Second Regulated Market without a prospectus.

Admission to the Official Market or the Second Regulated Market may be granted without requiring a listing prospectus in the above mentioned cases.

To supplement the existing supervisory rules such as the Capital Market Act (\textit{Kapitalmarktgesetz}), a specific legal framework has been put in place for the purposes of providing small and medium-sized Enterprises with finance via particular financing models. The Alternative Financing Act (\textit{Alternativfinanzierungsgesetz}) will make it easier for such companies to access the capital market. The Act also stipulates minimum standards for the operators of crowdfunding platforms. Neither a prospectus obligation nor an information obligation applies to a public offering of alternative financial instruments with a total value of up to EUR100,000 (or up to EUR750,000 in the case of shares in a cooperative). If the alternative financial instruments take the form of equities or bonds, a prospectus as defined by law must be published for any public offering in excess of EUR250,000. Public offerings of other alternative financial instruments up to a total amount of EUR1.5 million are only subject to certain information obligations. These include the obligation to publish the latest financial statements without delay and to provide an annual information update. For public offerings with a total value of EUR1.5 million upwards (or EUR250,000 upwards in the case of equities and bonds), a prospectus as defined by law must be published. Up to a limit of EUR5 million, the obligation to publish a prospectus may be met by preparing a simplified prospectus as defined in Annex F of the Capital Market Act. The provisions of the Alternative Financing Act apply to the calculation of this limit. If the total value exceeds EUR5 million or if the limit defined in the Alternative Financing Act is exceeded, the general obligation to publish a prospectus applies accordingly.

\textit{Last modified 6 Dec 2019}

\textbf{What are the main exchanges available?}

The main market for debt securities is the Vienna Stock Exchange (VSE).

Debt securities can be admitted to trading on one of the two regulated markets (that is, the Official Market and the Second Regulated Market) and the Third Market, which is operated as a multilateral trading facility (MTF).

The bond market is divided into the following segments:

- \textbf{Public sector} – This contains all debt securities issued by the federal government, entities under public law and supranational institutions.

- \textbf{Corporate sector} – This contains bonds issued by companies for the purpose of financing corporate activities.

- \textbf{Financial sector} – This contains bonds issued by banks, frequently used to refinance loans.

- \textbf{Performance-linked bonds} – This contains debt securities whose redemption price has not yet been fixed at the date of issue, as it is based on performance.

The admission criteria to be listed on the Official Market and the Second Regulated Market are set out in the Stock Exchange Act 1989 (SEA). Bonds that are admitted to listing on the Official Market or Second Regulated Market or admitted to trading in the Third Market include government bonds, federal treasury certificates, treasury notes, interest rate and government strips, corporate bonds, banking bonds and convertible bonds. The trading platform used is Xetra® with the trading procedure 'Auction Trading' (intra-day auction).

The public sector segment contains all debt securities issued by government bodies or that have a guarantee from the public sector: Austrian federal government bonds, Austrian Treasury bills (ATBs), bonds issued by provincial governments, bonds issued by other states etc.

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\textbf{Is there a private placement market?}

Austria has a private placement market. There is no dominant standard for documentation.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Austrian law. There are various statutory provisions aimed at investor protection relating to prospectus liability and liability for unsuitable advice on investments. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. However, where the interests of bondholders may be prejudiced the Austrian Custodian Act (Kuratorengesetz – KurG) provides that the competent Austrian court shall appoint a custodian in favor of the non-represented bondholders. This may, in particular, be the case where insolvency proceedings are opened with respect to the issuer or other circumstances generally affecting bondholders' rights occur. If a custodian is appointed, it will exercise the collective rights and represent the interests of the bondholders and will be entitled to make statements on their behalf that are binding on all bondholders.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

The Austrian Financial Market Authority (FMA) supervises various types of Austrian investment funds and their managers. Austrian investment funds supervised by the FMA are:

- alternative investment funds (AIFs) pursuant to the Alternative Investment Fund Managers Act 2013 (Alternative Investmentsfonds Manager-Gesetz 2013 – AIFMG 2013);
- investment funds pursuant to the Investment Fund Act 2011 (Investmentfondsgesetz 2011 – InvFG 2011); and

These funds are managed by investment fund management companies, real estate investment fund management companies and alternative investment fund managers (AIFMs).

As banks, investment fund management companies and real estate investment fund management companies are subject to supervision by the FMA. The FMA has also supervised AIFMs since 2014.

The FMA is required to perform the official tasks and use the powers as laid down in the abovementioned legislation (BWG, InvFG 2011, ImmoInvFG, AIFMG and, where applicable, the Securities Supervision Act 2018). Furthermore, the FMA is required to enforce numerous regulations.

What are common fund structures?

Common forms of funds include:

- open-ended and closed-ended funds;
- retail and non-retail funds;
- Undertakings for Collective Investments in Transferrable Securities (UCITS) and non-UCITS funds; and
- qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities and derivatives.

An investment fund is managed by an investment fund management company with the assets being held at a separate custodian bank. A capital investment fund established in accordance with the Investment Funds Act 2011 (InvFG 2011) is jointly owned by all unit holders.
Such funds include undertakings for collective investment in transferable securities (UCITS). The special assets must be held separately from the assets of the management company and no liability is assumed for the company's liabilities.

Umbrella constructions are also possible, in which a fund may consist of several sub funds, which might have different technical characteristics.

Alternative Investment Funds (AIFs) encompass every collective investment undertaking including its subfunds, that collect capital from a number of investors, in order to invest it in accordance with a determined investment strategy for the benefit of the investors. The collected capital may not directly be used for an operational activity and the fund is not subject to the UCITS Directive.

The types of AIFs addressed in the Investment Funds Act of 2011 (InvFG 2011 – Investmentfondsgesetz 2011) include special funds, other special funds and pension investment funds.

Real estate investment funds and real estate special investment funds pursuant to the Real Estate Investment Fund Act (ImmoInvFG – Immobilien-Investmentfondsgesetz) are also classified as AIFs.

As the scope of the Austrian Alternative Investment Fund Managers Act 2013 (AIFMG) is very wide it covers a wide range of funds, and hence, regulates the distribution of all kinds of AIFs. Only such investment undertakings which do not qualify as AIFs are not subject to those rules, such as operational companies or certain trust structures.

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**What are the differences between offering fund securities to professional / institutional or other investors?**

The Austrian Alternative Investment Fund Managers Act (AIFMG) only allows Alternative Investment Funds (AIFs) and non-EU AIFs to be placed in accordance with a dedicated set of rules, which do not provide for a private placement exemption.

The AIFMG does not impose an obligation to draw up a prospectus, however, it requires the submission of comprehensive information to the investors and the supervisory authorities. In addition, the Austrian Capital Markets Act provides the requirements for public offerings which also apply to AIF.

A substantial part of the AIFMG provides regulation for the marketing of AIFs. The provisions set out complex rules and distinguish between:

- whether the AIFM is licensed in Austria or in another EU Member State or it is a non-EU AIFM; and
- whether the AIF is an EU AIF or a non-EU AIF.

In general, an AIFM which is licensed in Austria is entitled to market EU AIFs to professional investors in Austria and in other EU member states. However, the marketing of AIFs to Private Investors and Qualified Private Investors is possible only under certain conditions. A ‘Qualified Private Investor’ is a person who owns free deposits and securities of more than EUR500,000, commits to invest at least EUR100,000 and does not invest more than 20% of its assets into an AIF.

The following AIFs are eligible for marketing to Private Investors and Qualified Private Investors:

- Real Estate Funds according to the Real Estate Fund Act (ImmoInvFG) provided that the AIFM holds a license pursuant to Sec 1 para 1 cf 13a Austrian Banking Act (BWG);
- Special Funds, Other Funds and Pension Investment Funds according to the Investment Fund Act (InvFG), provided that the AIFM holds a license pursuant to Sec 1 para 1 cf 13 BWG;
- AIFs in Real Estate provided that the AIFM holds a license according to the AIFMG;
-Managed Futures Funds subject to the conditions of sec 48 para 7 and 8 AIFMG provided that the AIFM holds a license according to the AIFMG;

- Private Equity Umbrella Funds according to the new sec 48 para 8a and 8b AIFMG;
- funds investing in interests of companies according to sec 48 para 8c and 8d AIFMG; and
• exclusively to Qualified Private Investors, AIFs which are authorized to be marketed to professional investors and provided that they do not employ leverage exceeding 30%.

Pursuant to sec 48 para 1a AIFMG the Private Investor and the Qualified Private Investor have to confirm in writing sufficient knowledge about the investment and the risks contained therein. The AIFM needs to be sufficiently convinced that the Private Investor and the Qualified Private Investor is able to assess the risk and the adequacy of the obligation related to the investment.

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Are there any other notable risks or issues around establishing and investing in funds?

The management of investment funds as specified in the InvFG 2011 is defined as a banking transaction pursuant to the Austrian Banking Act (BWG – Bankwesengesetz). This is why the BWG provisions also apply to investment fund management companies, unless they are explicitly exempted. Investment fund management companies are therefore considered special-purpose credit institutions.

With an appropriate license, they may also provide the investment services specified in the Securities Supervision Act 2018 (Wertpapieraufsichtsgesetz). In this case, the WAG 2018 provisions listed in Article 10 para. 5 of the InvFG 2011 must also be applied to them.

It should be noted that the InvFG 2011 not only includes regulations concerning Austrian undertakings for collective investment in transferable securities (UCITS), but also provisions on alternative investment funds (AIFs). Such AIFs could be other special assets, pension investment funds and special funds.

Most Austrian investment fund management companies not only manage UCITS, but also AIFs. Consequently, these companies are also alternative investment fund managers (AIFMs), that hold a license pursuant to the InvFG and a license pursuant to the Alternative Investment Fund Managers Act (AIFMG, Alternatives Investmentfonds Manager-Gesetz).

The activities of alternative investment fund managers (AIFMs) are specified in the Alternative Investment Fund Managers Act (AIFMG; Alternatives Investmentfonds Manager-Gesetz), which is based on Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD). This Directive divides investment funds within the EU into two categories:

• undertakings for collective investment in transferable securities (UCITS); and
• alternative investment funds (AIFs).

In order to be allowed to manage AIFs, the alternative investment fund manager must be licensed as an AIFM. If the AIFM does not exceed certain threshold values with regard to the assets they manage, they may simply register their services instead of obtaining a license. In this context it should be noted that registered AIFMs are not permitted to market any AIFs to retail investors or qualified retail customers, or to engage in cross-border marketing or cross-border management.

The Real Estate Investment Fund Act (ImmoInvFG, Immobilien-Investmentfondsgesetz) regulates the management of real estate funds by investment fund management companies. Investment fund management companies for real estate are the only companies authorized to issue and manage this type of fund. These special-purpose credit institutions possess a restricted banking license pursuant to Article 1 para. 1 no. 13a Banking Act (BWG) and are subject to supervision by the FMA. Real estate investment fund management companies also hold a license pursuant to the AIFMG, as real estate funds and special real estate funds are classed as AIFs. The AIFMG provisions must therefore also be applied to real estate investment fund management companies.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Prior to the implementation of the Alternative Investment Fund Managers Directive (AIFMD), foreign investment funds were distributed in Austria either by way of a ‘public offer’ or a ‘private placement’. With the implementation of the AIFMD, this regime has been abolished.
Now all AIFs being ‘marketed’ to investors in Austria have to be notified with the Financial Market Authority and have to comply with certain regulatory obligations. However, depending on the specific circumstances and a case by case analysis ‘reverse solicitation’ seems possible.

Austria has also ‘opted in’ for the option provided for in Article 43 of the AIFMD and allows for marketing to retail investors. However, this possibility is limited to certain fund structures and subject to additional notification requirements.

An extension of the passporting regime to non-EU Alternative Investment Fund Managers (AIFMs) and non-EU Alternative Investment Funds (AIFs) is contemplated by the AIFMD. However, respective EU legislation will have to be passed prior to implementation. Austria has exercised the option provided for in Article 42 of the AIFMD and allows the marketing of AIFs managed and marketed by non-EU AIFMs to professional investors, subject to certain additional Austria specific conditions and notification requirements as provided for in the Alternative Investment Fund Managers Act (AIFMG). This is an opportunity for non-EU AIFMs to continue or start marketing of their AIFs in Austria.

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Are there any restrictions on managing a fund?

The Alternative Investment Fund Managers Act (AIFMG) in line with the Alternative Investment Managers Directive (AIFMD) is fund manager focused and introduces a new licensing requirement for such managers as well as a number of organizational and structural requirements to be met. An advantage of this licensing requirement is that once a fund manager situated in the EU is authorized by its home member state it will be able to passport its manager license to all other member states and market the Alternative Investment Funds (AIFs) it manages to professional investors in any other member state without an additional licensing requirement.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

As a general rule, a person entering into a derivatives contract by way of business in Austria (for example a dealer) will ordinarily need to be authorized under the Austrian Banking Act (Bankwesengesetz, BWG) or the Austrian Securities Supervision Act (Wertpapieraufsichtsgesetz, WAG) if the transaction is one of the specified activities. These activities include trading in:

- options;
- futures;
- contracts for difference; or
- rights to or interests in investments.

One of the key exceptions to the requirements above applies to persons who deal in derivatives for risk management purposes (for their own account).

The European Market Infrastructure Regulation applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

Certain governmental entities as well as insurance and investment funds are subject to specific statutory rules limiting their ability to enter into derivatives contracts.

The clearing and settlement of Austrian securities had previously been dealt with by Oesterreichische Kontrollbank (OeKB). As of January 2005, CCP Austria, a company owned jointly by Wiener Börse AG and OeKB, began operations for the clearing and settlement of all cash market and derivatives trades.

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What are common types of derivatives?

Derivative contracts are entered into in Austria for a range of reasons including hedging, trading and speculation. Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in Austria:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of a derivative contract is based on the value of the underlying assets. The main classes of underlying asset in Austria are:

- equity;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen, and continues to see, the introduction of a significant amount of new regulation which has led to substantial compliance costs for market participants.

Austria has recently seen a number of municipalities invoking different forms of an ultra vires defense against the enforcement of derivatives contracts. Following similar case law in Germany, there have also been cases where banks have been prevented from enforcing derivatives contracts against customers based on the argument that they withheld information according to which the derivative contract in question had a negative value at the time of conclusion of the contract. Finally, there have been occasional attempts, especially by smaller investors to invoke the gambling defense against the enforcement of derivatives contracts.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending is restricted under civil law by the general principle of good morals (gute Sitten) and by the limits of laesio enormis (that is, where parties to a contract are entitled to rescind certain unfair contracts) from exploiting the carelessness, plight or inexperience of the
contracting partner and charge monetary advantages that are clearly inappropriate. Extortionate loans are void and may also result in criminal liability.

Stock companies and limited liability companies are prohibited by law from granting financial assistance either in the form of a loan or credit support by providing a guarantee or other security for the purpose of purchasing its own shares. This also applies to limited liability companies in compliance with the capital maintenance rules.

Loans to managing directors may be subject to particular approval requirements.

Finally, a debt may be deemed to be of equity in nature and repayment may be forbidden if the loan was granted in the period prior to a borrower's insolvency and when borrower is insolvent and the lender either holds more than 25% of the borrower's shares or otherwise exerts control over the borrower.

There are no restrictions on granting security to a foreign lender or on a foreign lender making loans; however, engaging in banking or financial services may require a banking license. There is also a duty to notify to the Austrian Central Bank of certain cross-border business for statistical purposes.

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What are common lending structures?

Lending in Austria can be structured in a number of different ways in order to include a variety of features depending on the commercial needs of the parties. A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Credit agreements have represented and still represent the most important instrument in terms of debt financing. However, more and more financing products have been developed and used in Austrian financing transactions, such as mezzanine debt financing, equity kickers and hybrid instruments.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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What are the differences between lending to institutional / professional or other borrowers?
Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, mortgages and consumer lending is governed by the Mortgage and Real Estate Credit Agreements and Other Credit Agreements in favor of Consumers (Hypothekar- und Immobilienkreditgesetzes – HIKrG) and the Consumer Credit Act (Verbraucher kreditgesetz – VerbrKrG).

Do the laws recognize the principles of agency and trusts?

The concept of facility agents, who act in the name and on behalf of the lenders in a syndicate, is recognized under Austrian law. However, under Austrian law security can only be given directly to the creditor as a secured party.

Pursuant to mandatory provisions of Austrian law a security agent (holding accessory security) must be a joint and several creditor (Gesamtgläubiger) under the loan agreement. A common alternative is to use an agreement stating that the security agent would be granted a claim vis-à-vis the borrower, which corresponds exactly to the outstanding claims under the loan agreement (a so-called parallel debt structure).

A valid and enforceable security interest can only be created in favor of the creditor of the obligation to be secured. A trust created under the common law of another country is not recognized in Austria and, therefore, a security trustee cannot enforce its rights in the Austrian courts.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. An irrevocable expression of intent (Willenserklärung) may nonetheless be terminated if there is a fundamental change in the circumstances that existed when the expression of intent was made (Wegfall der Geschäftsgrundlage) or for good cause (wichtiger Grund). Irrespective of the provisions of the documents, stipulations that purport to exclude a person’s right to terminate an agreement for good cause (aus wichtigem Grund) or to request early repayment/redemption following the occurrence of such good cause (wichtiger Grund) would not be enforceable.

Specific types of lending

Mortgages and consumer loans are highly regulated activities. A number of requirements are imposed on a lender including:

- the lender shall provide the borrower at any time with prescribed minimum information regarding the content of the contract (eg credit purpose, possible duration, types of offered interest rates or a representative example), either in written or electronic form;
- the lender shall deliver the European Standardized Information Sheet (ESIS) to the borrower containing tailored information purposes;
- the borrower shall be given a right to withdraw from the contract; and
- specific disclosure requirements with regard to amortization, change of interest rates, early prepayment etc.

Standard form documentation

Most syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association and adapted to Austrian law. Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

Are there any other notable risks or issues around borrowing?
Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD) as well as the Austrian Recovery and Resolution of Credit Institutions Act (Bundesgesetz über die Sanierung und Abwicklung von Banken – BaSAG), which outline certain measures for dealing with failing financial institutions.

The provisions apply to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

The provisions give authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Austrian or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would prevent this.

Financial assistance

A parent company may guarantee the obligations of its subsidiary under a third party loan without violating any corporate benefit rules; however, for a company benefitting from limited liability and limited partnerships (with limited liability companies as partners) it is not allowed to grant security for the obligation of an indirect parent or sister company unless the transactions were at arm's length or justified by a corporate benefit. Under Austrian law transactions violating capital maintenance rules are null and void (and even security granted to third parties may not be enforceable).

Insolvency

Guarantees and security may be at risk of being set aside under Austrian insolvency laws if the guarantee or security was granted by a company within a certain period of time prior to the onset of insolvency. Guarantees and security may also be challenged on other grounds relating to insolvency.

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What are common types of guarantees and security?

Guarantees are commonly used in Austria and are created by way of an agreement between the guarantor and the beneficiary or by unilateral declaration of the guarantor. They may be provided as either of the following.

Suretyship (Bürgschaft)

This is where the guarantor undertakes to settle certain obligations of a debtor in the event of default. It is an accessory security and therefore conditional on the debtor's default; and a valid and existing underlying obligation of the debtor.

Guarantee

This is where the guarantor promises to pay a certain amount of money on the formal request of the beneficiary under the guarantee. The guarantor's obligation is abstract and therefore (unlike a personal guarantee) independent from any underlying legal relationship.
between the beneficiary as creditor and his debtor.

**Common forms of security**

The most common forms of security over immovable property are as follows.

**MORTGAGE (HYPOTHEK)**

This is the transfer of an interest in property to a creditor as security for a debt. The debtor has a right of redemption if the terms of the mortgage are satisfied or performed.

**TRANSFER OF TITLE IN PROPERTY (SICHERUNGSÜBEREIGNUNG)**

This is where ownership is transferred from the transferor (debtor) to the transferee (creditor). However, the transferee holds the property as trustee for the transferor. Full ownership reverts to the transferor when it fulfils its obligations.

Both types of security can be enforced by either of the following means:

- auctioning the property; and
- putting the property under forced administration.

If the creditor wants to recover its claims in the form of income from rental or lease fees, it must choose forced administration.

The most common forms of security over movable property are as follows.

**PLEDGE (PFAND)**

A way of creating security by delivering an asset to a creditor to hold until an obligation is performed. The creditor takes possession of the asset while the debtor retains ownership. The creditor can sell the pledged asset if the obligation is not performed. Claims can also be pledged. Since no physical possession of a claim is possible, they are pledged by notifying the third party debtor.

**SECURITY TRANSFER (SICHERUNGSÜBEREIGNUNG)**

This is where in a security transfer, ownership is transferred from the debtor as transferor to the creditor as transferee, while the object remains in the transferor’s possession. The advantage over the pledge is that the object remains usable by the debtor.

**ASSIGNMENT (SICHERUNGSABTRETUNG)**

This is where a debtor can assign claims it has against a third party. The assignment is usually not disclosed to the third party. If the debtor defaults, the creditor can disclose the assignment and seek payment directly from the third party.

Are there any other notable risks or issues around giving and taking guarantees and security?

**Giving or taking guarantees**

No further specific issues – however, suretyships may trigger stamp duty under the Austrian Stamp Duty Act (GebG).

**Giving or taking security**

The relevant formalities for security are:

- **Mortgages and transfers of title in property** – These must be notarised and registered with the Land Registry (Grundbuch). Failure to comply with these formalities renders the security invalid.

- **Pledges** – A claim can only be pledged if the third party debtor is sufficiently notified of the pledge. If a physical asset is being pledged
it either must be transferred to the pledgee or held by a person on the pledgee’s behalf. Failure to comply with these formalities renders the security invalid.

- **Security transfers and assignments** – There are no specific formalities for assignments and security transfers.

**Financial regulation**

**Law and regulation**

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

Financial Market Authority Act 2011 (*Finanzmarktaufsichtsbehördenbesetz 2011*) (organization of the Financial Market Authority)
Insurance Supervision Act 2016 (*Versicherungsaufsichtsgesetz 2016*) (insurance companies)
Securities Supervision Act 2007 (*Wertpapieraufsichtsgesetz 2007*) (dealing with securities)
Capital Market Act 2011 (*Kapitalmarktggesetz 2011*) (public offering of securities and other financial instruments)
Banking Act 1993 (*Bankwesengesetz 1993*)
Securities Depository Act 1969 (*Depotgesetz 1969*) (purchase and disposition of securities)
E-Money Act 2010 (*E-Geldgesetz 2010*) (electronic money and regulating the conduct of institutions emitting electronic money)
Payment Services Act 2009 (*Zahlungsdienstegesetz 2009*) (offering of payment services)
Recovery and Resolution of Credit Institutions Act 2014 (*Bundesgesetz über die Sanierung und Abwicklung von Banken 2014*) (financial recovery and liquidation of credit institutions)
Austrian Custodian Act 1874 (*Kuratorengesetz 1874*) (joint representation of bearers of bearer bonds)
Austrian Stamp Duty Act 1957 (*Gebührenbesetz 1957*) (stamp duty)

**Consumer credit**

Consumer Protection Act 1979 (*Konsumentenschutzgesetz 1979*) (protection of consumer rights)
Consumer Credit Act 2010 (*Verbraucherkreditgesetz 2010*) (loans and other forms of credit to consumers)

**Mortgages**

Austrian Civil Code (*Allgemeines Bürgerliches Gesetzbuch*)
Mortgage Credit Directive (2014/17/EU Richtlinie über Wohnimmobilienkreditverträge)
Act on Mortgage and Real Estate Credit Agreements and Other Credit Agreements in favor of Consumers 2016 (*Hypothekar- und Immobilienkreditgesetz 2016*)

**Corporations**

Stock Corporation Act (*Aktiengesetz – AktG*)
Limited Liability Companies Act (Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbH)
Austrian business enterprise code (*Unternehmensgesetzbuch – UGB*)

**Funds and platforms**

Investment Fund Act 2011 (*Investmentfondsgesetz 2011*)
Alternative Investment Fund Managers Act 2013 (*Alternative Investmentsfonds Manager-Gesetz 2013*)
Real Estate Investment Funds Act 2003 (*Immobilien-Investmentfondsgesetz 2003*)
Other key market legislation

UCITS Directive (1985/61/EWG, OGAW Richtlinie)
EU Prospectus Regulation (2017/1129/EU, Prospekterordnung)
Capital Requirements Regulation (2013/33/EU, Kapitaladäquanzverordnung) (capital requirements)
European Market Infrastructure Regulation (2012/64/EU – EMIR) (derivatives)
Market Abuse Regulation (2014/596/EU, Marktmissbrauchsverordnung) (market abuse)
Markets in Financial Instruments Directive II (2014/65/EU – MiFID II) (financial instruments)
Clearstream’s Central Securities Depositories (2014/909/EU – CSDR, Zentralverwahrerverordnung)
Financial Account Tax Compliance Act 2010 (FATCA)
Basel IV: International framework for liquidity risk measurement, standards and monitoring
Bank Recovery and Resolution Directive (BRRD)

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Regulatory authorization

Who are the regulators?

The Financial Market Authority supervises various institutions including less significant banks, insurance undertakings, pension companies, corporate provision funds, investment firms and service providers, investment funds, financial conglomerates and stock exchanges. It also monitors compliance with legal requirements, and ensures fairness and transparency in relation to the trading of listed securities, capital market prospectuses, compliance and rules of conduct, any unauthorized offering and provision of financial services, and the observance of anti-money laundering and terrorist financing rules.

The Ministry of Finance supervises the Financial Market Authority.

The Österreichische Nationalbank (OeNB) is the central bank and is in charge of monetary policy, financial stability, supplying Austria with cash, providing financial statistics and facilitating cashless payments.

What are the authorization requirements and process?

The vast majority of authorizations are obtained from the Financial Market Authority.

The Financial Market Authority assesses whether or not the legal requirements are fulfilled and also the eligibility of certain key individuals. It bases its decision on documents to be provided by the applicant, including the business plan, the initial capital and the identity of the key individuals. Before issuing its decision, the Financial Market Authority must consult the Ministry of Finance and the Österreichische Nationalbank.

Authorized firms are listed in a database maintained by the Financial Market Authority.

Other authorities are responsible for authorizations of stock brokers, currency exchanges, Central Counterparties according to European Market Infrastructure Regulation, central securities depositories according to CSDR (Clearstream's Central Securities Depositories – Zentralverwahrerverordnung), financial advisors (Vermögensberater) and certain special institutions such as the post office, Österreichische National Bank, Austrian Control Bank (Österreichische Kontrollbank – OeKB) and certain local authorities.

The fee depends on the scope of the authorization and amounts to at least EUR10,200.
What are the main ongoing compliance requirements?

The main ongoing compliance requirements are maintenance of capital and liquidity requirements and observance of large exposure limitations. Failure to comply with these can result in loss of authorization.

Other key compliance requirements include preserving banking secrecy, combatting money laundering and terrorist financing and ensuring internal auditing. Furthermore the Financial Market Authority enjoys the power to issue decrees to further specify rules and (to a limited extent) impose rules. Failure to comply, generally can result in fines. Competitors may also be able to sue the non-compliant company on the basis that they have been engaging in unfair competition. Breach of banking secrecy can be a criminal offence and result in imprisonment.

What are the penalties for failure to be authorized?

The penalty for undertaking a regulated activity without authorization is a fine, which can be up to EUR5 million or twice the amount of the profit received from undertaking the activity. There is a possibility that such activity could also be classified as a criminal offence (deception).

Regulated activities

What finance and investment activities require authorization?

Generally

The finance and investment activities requiring authorization are explicitly stipulated in the Banking Act 1993. In order to conduct one of these activities in Austria on a commercial basis (which broadly corresponds to having an 'intent to realize a profit') requires authorization.

The activities include:

- deposit business;
- clearing;
- credit business;
- bill-broking;
- security deposit business;
- issuance and administration of instruments of payment;
- trading in foreign exchange instruments, money market instruments, derivatives and securities;
- guarantee business;
- securities issuance business;
- investment fund business including real estate investment fund business; and
- factoring.

Consumer credit

From a regulatory perspective, consumer credit activities are not treated any differently to other credit business, ie they require prior
authorization if conducted in Austria and on a commercial basis. However, additional rules apply including additional civil law rules. Examples for such additional civil law rules include the limitation to use certain clauses in general terms and conditions for consumers, additional requirements before taking security from consumers and additional information requirements before entering into a distance contracts.

_Last modified 6 Dec 2019_

**Are there any possible exemptions?**

Credit institutions and financial institutions which passported their respective authorizations to Austria are only subject to a limited set of Austrian rules and otherwise only to the rules of their home member states.

_Last modified 6 Dec 2019_

**Do any exchange controls or other restrictions on payments apply?**

There are no foreign currency controls other than sanctions imposed by the EU or international law if transferring money to and from non-EU member states. Declaration requirements may apply.

The EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be complied with.

Anti-money laundering and tax considerations may also need to be taken into account.

_Last modified 6 Dec 2019_

**What are the rules around financial promotions?**

**Rules**

The promotion of finance and investment activities can qualify as 'acting on a commercial basis' and therefore require an authorization.

There are no restrictions on promotion for authorized entities. However, there are detailed information obligations upon such entities, especially in relation to consumers.

**Exemptions**

There are no general exemptions.

_Last modified 6 Dec 2019_

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

The Banking Act 1993 provides that in order for an entity to apply for authorization, it must be a capital company (*Kapitalgesellschaft*), cooperative (*Genossenschaft*) or savings bank (*Sparkasse*). Any other legal entities are not eligible for authorization. All of these are body corporates with separate legal personality (for purposes of both civil and tax law) and limit the liability of their shareholders or members respectively. The liability of a company's shareholders is limited by shares, meaning that the shareholders are liable to pay for their shares but not the company's debts.

**Funds**
Management companies of investment funds (Verwaltungsgesellschaften) require a banking license and are therefore subject to the same rules and requirements as described above.

The investment fund itself however, does not have its own legal personality. It is a separate estate (Sondervermögen) to which special rules apply, eg it consists of share certificates which must be of equal value and which represent:

- co-ownership in the investment fund; and
- certain rights and obligations vis-à-vis the management company as well as the depositary bank.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A company can conduct lending or investment business through a branch which does however, not create a separate legal entity. Credit institutions and financial institutions from other EU member states may passport their respective authorizations to Austria via their home state authorities. All other entities must apply for an Austrian authorization.

Foreign entities which have a branch in Austria must comply with different rules including registration (companies register act and business enterprise code), accounting (business enterprise code) and disclosure (business enterprise code and banking act). Credit institutions and financial institutions which passported their respective authorizations to Austria must observe a catalogue of Austrian rules including rules on consumer protection and protection of young people, banking secrecy and anti-money laundering and terrorism financing. Otherwise they are supervised by their respective home state authority. All other foreign entities must observe all Austrian rules and regulations including supervision by the Austrian authorities.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending includes peer-to-peer (P2P) type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.
ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.
WHAT IS A CRYPTOCURRENCY?

Cryptocurrency or virtual currency is legally defined for the first time in the Anti Money Laundering Directive (RL (EU) 2018/843) (Article 3 (18): virtual currencies” means a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically.

The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchaser.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.
Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

Many alternative investments are now offered via platforms on the internet (sometimes also referred to as ‘crowdfunding platforms’). Whether such platforms are subject to supervision depends on both their activities and the instruments which are offered on them. Some platforms are subject to securities supervision law (usually as they involve the brokerage of shares or bonds), while others do not require a license and are not supervised. Credit brokerage platforms can rarely be operated without a licensed partner due to the fact that such lending business constitutes a banking transaction. Furthermore such platforms are not usually permitted to transfer payments between users unless they are authorized to do so.

There are specific obligations under Austrian law, in particular, with respect to investor information regarding platforms that broker alternative financial instruments in accordance with the Alternative Financing Act (Alternativfinanzierungsgesetz or AltFG), the law applicable to most alternative financial instruments.

FinTech models may be offered by financial market participants under the supervision of the Austrian Financial Markets Authority (FMA) such as banks and insurance companies. FinTechs that are not supervised by the FMA may only provide their services either outside the scope of transactions that require a license, or in cooperation with market participants that hold the requisite license. It is often difficult to determine which approach applies, so the FMA provides support to FinTechs in clarifying what is possible. If, however, any suspicion arises that transactions are being conducted without the requisite license being held, then the FMA is required to investigate – see Article 22b of the Financial Market Authority Act (Finanzmarktaufsichtsgesetz or FMABG) on unauthorized business operations – and, where applicable, to prohibit the activity from being conducted as well as to initiate administrative penal proceedings. The FMA therefore has multiple functions in this field: on the one hand it supervises FinTechs holding the requisite licenses as well as licensed entities with FinTech divisions, while also providing clarification about whether a license is required and whether authorized business operations are potentially being conducted.

RELEVANT REGULATORY PROVISIONS AND BUSINESS OPERATIONS

The FMA initiates investigations if it suspects that unauthorized business operations are being conducted. The FMA receives information and tip-offs from market participants and other authorities as well as from its own market monitoring. Unauthorized business operations are deemed to exist if they are conducted without the appropriate license.

The following transactions, conducted in Austria on a commercial basis, require a license from the FMA:

- conducting banking transactions (Article 1 paragraph 1 of the Austrian Banking Act (Bankwesengesetz or BWG));
- providing payment services (Article 1 paragraph 2 of the Payment Services Act (Zahlungsdienstegesetz or ZaDiG));
- providing investment services (Article 3 paragraph 2 of the Securities Supervision Act 2018 (Wertpapieraufsichtsgesetz or WAG));
- operating a securities exchange (Article 3 paragraph 2 of the Stock Exchange Act (Börsegesetz or BörseG));
- managing an alternative investment fund in accordance with the Alternative Investment Funds Manager Act (Alternative Investmentfonds Manager-Gesetz or AIFMG));
- issuing electronic money in accordance with the Electronic Money Act (E-Geldgesetz or E-GeldG);
- establishing and operating a Pensionskasse (pension company) in accordance with the Pension Funds Act (Pensionskassengesetz or
PKG; and

- operating contractual insurance in accordance with the Insurance Supervision Act 2016 (Versicherungsaufsichtsgesetz 2016 or VAG 2016).

**Regulation of peer-to-peer lenders**

Until 2015, no legal framework consisting of special law provisions existed regulating the activity of peer-to-peer (P2P) platforms. The AltFG, which has been in force since 2015, governs the activity of platforms but only to the extent that projects are mediated via the platforms that are qualified as 'crowdinvesting'. It has to be taken into consideration that the Austrian market (compared to some other European jurisdictions) has been limited so far and will remain limited.

The legally permitted field of application of crowdfunding platforms in Austria is restricted as far as commercial lending by private parties is concerned. Commercial lending is only permitted with a banking license pursuant to section 1 paragraph 1 clause (e) of BWG. The amount of the loan granted does not play a role (eg multiple awards of EUR25 loans triggers the license obligation).

The FMA takes a hard line in preventing the unauthorized operation of banking business. For example, in 2009 the FMA prohibited an Austrian P2P platform named 'bankless life' from receiving deposits on the grounds that the club operating the platform was accepting illicit deposits since it did not possess a banking license.

P2P platforms on which private or mortgage loans are procured require either a license under BWG or they have to register at the competent trade authority for the brokerage of private or mortgage loans.

A simple registration under industrial trade law at the locally competent regional administrative authority is only sufficient if the platform works together with a licensed credit institution that possesses a license for deposit business, since in that case, loan funds of the investors are 'collected' on the accounts of the credit institution.

The fact that the brokerage of private or mortgage loans is also regulated by the Austrian Industrial Code (Gewerbeordnung or GewO), is however not an obstacle to the activity of P2P platforms in Austria. Notably, some German platforms have offered their services in Austria.

It has to be pointed out again that 'crowdlending' (ie in particular lending among private persons without intervention of a credit institution) is excluded from the scope of AltFG's application. The latter only covers so-called 'crowdinvesting' (ie the granting of financial capital in exchange for financial instruments and investments etc).

P2P lending does not currently present a real or potential threat to the traditional banking sector in Austria. That said, banks (naturally protective of their market share) have been seen to cooperate with P2P lending platforms.

**Regulation of payment services**

**The Payment Services Act**

ZaDiG came into force on 1 November 2009. ZaDiG heralded two significant innovations: the detailed legal framework for the provision of payment services as well as the introduction of the aforementioned payment services (businesses/license categories).

Before then, the provision of payment services, in particular transfers, credit card payment and payment using mobile phones was not fully regulated. Following ZaDiG, precise legal provisions now exist, primarily to protect consumers.

The tasks performed by payment institutions address a broad range of aspects concerning payment services. Each type of activity requires a separate license, which is granted by the respective supervisory authority. Payment services requiring a license are set out ZaDiG, and under Austrian law may be any of the following:

- deposit and withdrawal transactions;
- payment transactions (eg direct debit, payment card and credit transfer transactions);
- payment transactions involving the granting of credit;
- payment instrument transactions;
- money remittance transactions; and
- digitalized payment transactions.
In addition to payment institutions, the following are also permitted to provide payment services within their administrative jurisdiction:

- credit institutions;
- electronic money institutions;
- the Oesterreichische Nationalbank; and
- the Government of the Republic of Austria and the provinces.

In the case of credit institutions, the services they are allowed to provide depends on which banking transactions they are authorized to conduct. Unlike credit institutions, payment institutions are not permitted to conduct other services over and above those listed above. Other business, which requires a banking license, in particular the deposit-taking business, is not permitted to be conducted by payment institutions.

**Application of data protection and consumer laws**

Recent fraud-related scandals involving P2P and crowdfunding platforms have served as stark reminders of the risks of using FinTech when appropriate regulation and compliance processes are not in place. FinTech users are concerned about fraud, so for the FinTech sector to survive, it must be protected against fraudulent activity.

**CONSUMER PROTECTION OVERVIEW**

Consumers (in particular borrowers) are well protected in Austria by rules which are directly and indirectly enforced by the FMA. The FMA's consumer protection activities in 2016 generally focused on companies' compliance with their information and notification duties (both to the FMA and consumers) as well as complaint handling procedures. In 2016 virtual currencies and the reduction of foreign currency loans in the consumer sector were a special focus of the FMA.

Banks that infringe the administrative provisions of consumer protection laws face administrative fines imposed by the FMA and could be sued by consumers who incur damage as a result of such breaches.

Additionally consumers may also contact the ombudsman of the Joint Alternative Dispute Resolution Institution of the Austrian Credit Institution Sector, or (but only with respect to foreign currency loans) the Alternative Dispute Resolution Institution for Consumer Deals. Both bodies are responsible for out-of-court settlement of consumer disputes and competent bodies under Article 3 of the Alternative Dispute Resolution Act (which implements Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No. 2006/2004 and Directive 2009/22/EC). Generally alternative dispute resolution procedures require the consent of the defendant; they are not mandatory, meaning a bank may refuse to participate, which leaves the consumer with the option to file a claim.

Furthermore, consumers may approach the Consumer Association for Consumer Information (VKI), the most well-known, organized and powerful consumer association in Austria. The VKI is very active with respect to the supervision of general terms and conditions of banks and investment funds; it has fought and won many actions for consumers leading to a detailed and consumer-friendly Austrian Supreme Court practice in recent years.

Austria has implemented Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes through the Deposit Guarantee and Investor Protection Act (ESEAG), which has led to a reorganization of Austrian deposit guarantee schemes to comply with European law standards. Following a transposition period until the end of 2018 (until which time the system of deposit guarantee schemes will be regulated on the level of financial market sectors and on an institutional level), as of 1 January 2019, a single deposit guarantee and investor protection scheme shall be applicable for all depositors with credit institutions in Austria.

**DATA PROTECTION OVERVIEW**

The General Data Protection Regulation (GDPR) entered into force on 25 May 2018. All data processing must comply with this legal situation. While the GDPR is directly applicable in every EU Member State as an EU Regulation, it does contain numerous so-called ‘opening clauses’ allowing national leeway. In order to implement these opening clauses and margins, two amendments to the Data Protection Act (the “Data Protection Adaptation Act 2018” and the “Data Protection Deregulation Act 2018”) were passed in Austria (in addition to amendments to numerous material laws).

The possible sanctions under the GDPR can be up to EUR20 million or 4 % of annual turnover. According to the concept of the Austrian
administrative penal provisions (Verwaltungsstrafrecht), such sanctions would be imposed on the management of a company unless a responsible representative (Verantwortlichen Beauftragten) is appointed.

The concept of an association’s direct responsibility is rather uncommon under Austrian administrative law (implemented eg in paragraph 99d of the Banking Act). The Data Protection Act provides that GDPR fines can be imposed on legal entities if the underlying offence was caused by its management or responsible representative.

**Money laundering regulations**

Provisions relating to the prevention of money laundering and terrorist financing are set out in various legal acts in Austria. For financial market participants, the provisions contained in the following laws and regulations apply:

- the BWG;
- the VAG 2016;
- the ZaDiG;
- the WAG;
- the E-GeldG;
- the AIFMG; and
- the Regulation on Money Laundering and Terrorist Financing Risk 2016 (Geldwäscherei- und Terrorismusfinanzierungsrisiko-Verordnung 2016 or GTV 2016).


On 26 June 2015 the Fourth Directive on Money Laundering (Directive 2015/849) as well as the new Regulation (EU) 2015/847 on information accompanying transfers of funds (Regulation on the Transfer of Funds) entered into effect. This new anti-money laundering package by the European Union includes the adoption and implementation of the 40 recommendations amended in 2012 by the Financial Action Task Force (FATF). The aim of the Fourth Money Laundering Directive is to prevent the misuse of the European Union's financial system for the purposes of money laundering and terrorist financing, and thereby to protect the integrity and stability of the financial system.

The so-called “fifth money laundering directive” Directive (EU) 2018/843 has been in force since 30.5.2018. The changes to this policy should be read in conjunction with the Fourth Money Laundering Directive. It also provides for the first time a definition of the “virtual currency”.

In this context, the FMA monitors supervised entities’ compliance with the legal and due diligence obligations in relation to combatting money laundering and terrorist financing. In the event that these obligations are breached, the FMA takes the necessary steps, such as onsite inspections and supervisory inspection procedures.

*Last modified 6 Dec 2019*

**What type of funding arrangements and incentives are available to FinTech businesses?**

**General**

Austria has been recognized as one of the most interesting international startup hotspots. The startup community, and particularly the FinTech startup community, is growing day-by-day and a lively ecosystem has developed as a result.

One of the reasons for such development is that Austria's environment perfectly fits startups' needs. New services are available online, providing any kind of information that could be useful for startups.

**THE STARTUP PROGRAM BY THE AUSTRIAN FEDERAL GOVERNMENT**

The Austrian Federal Government launched a comprehensive startup program in 2016, covering a period of three years and entailing a
volume of about EUR185 million. It consists of a number of initiatives, including:

- the creation of a new legal entity, the medium-sized financing company (Mittelstandsfinanzierungsgesellschaft or MiFiG), aiming to stimulate investors into providing risk capital for small and medium-sized companies; and
- tax exemption for applying up to EUR15,000 in dividends for investors in a MiFiG.

MiFiGs were introduced on 1 January 2008. The following conditions must be met to qualify as an MiFiG:

- The MiFiG must be established in the form of a limited liability company (Gesellschaft mit beschränkter Haftung or GmbH) or a stock corporation (Aktiengesellschaft or AG) with a minimum share capital of EUR7.3 million.
- The purpose of the MiFiG is limited to investing money and it cannot carry out its own business.
- Only 50% of the MiFiG’s shares can be held by public bodies and organisations.
- The MiFiG must invest at least 70% of the funds in companies. The remaining 30% of the funds can be held as cash, bank deposits or in the form of bonds.

A MiFiG’s earnings derived from investments in companies (Finanzierungsbereich) are tax exempt, but its earnings derived from bank deposits and bonds (Veranlagungsbereich) are not. A MiFiG must comply with section 6b of the Corporate Income Tax Law (Körperschaftsteuergesetz or KStG) for at least seven years, or the tax exemptions are retroactively revoked. MiFiGs are also tax exempt from capital duty and stamp duties occurring in connection with establishment. However, the tax exemptions under the MiFiG regime only apply to investments made before 31 December 2012 and there are currently no tax exemptions or benefits comparable to the MiFiG regime. Investments made before 31 December 2012 continue to benefit from the exemption of corporate income tax, under certain circumstances, until the beginning of the first business year after 31 December 2018.

At the beginning of 2019 plans were made regarding a new startup package, but not yet implemented.

RESEARCH FUNDING IN AUSTRIA

Research funding in Austria is based on a diversified range of funding instruments, encompassing a research premium, tax advantages and direct funding granted by three institutions:

- Whoever carries out research in Austria pays lower taxes – this applies to all companies in Austria. Companies are entitled to claim a 12% research premium (from 2018 on even 14%) paid in cash on in-house research expenditures as well as contract research.
- The Austrian Research Promotion Agency (FFG) promotes research and development by companies along the entire innovation chain via research grants. Funding volume in 2018 was EUR685 million (including EUR123 million broadband infrastructure).
- The Austrian Science Fund (FWF) is the country's central body for the promotion of basic research. Approved funding volume in 2018 was EUR230,8 million.
- Austria Wirtschaftsservice GmbH (AWS) is the funding bank for corporate business development. Total funding in 2017 was EUR1,145.4 billion.
- The funding initiative COMET (Competence Centers for Excellent Technologies) promotes the cooperation between companies and scientific facilities within the context of a jointly defined but high-level research program. Up until now 49 competence centers on three different levels have been established. A total of EUR2,24 billion will be invested in the period 2006 to 2019.

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING
The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

Some of the large banks in Austria have their own reward-based or donation-based crowdfunding platforms. Overall, the banking sector is becoming more and more interested in crowdfunding, as it can be seen as a valuable tool for risk minimization. In economically difficult times when banks may not be lending freely, equity-based crowdfunding may also be a viable alternative to raising capital for startups and small businesses, and especially if combining these investments with traditional financing instruments.

**Accelerators**

**AUSTRIANSTARTUPS**

AustrianStartups is a non-profit platform of, by and for the Austrian startup community to increase its visibility and strengthen the entrepreneurial ecosystem. It has created an event calendar for startups where it is possible to find most of the relevant upcoming startup events in Vienna and Austria. These events are the best places to implement networking strategies to find potential partners and talent for working with and creating value.

**SPEEDINVEST**

The most recognized Venture Capital fund in Austria is SpeedInvest; it specializes in FinTech, technology, media-centric and e-commerce segments from CEE countries. It works hands-on with founders and partners. Startups which have their product and team ready can receive up to EUR500,000 in seed-round funding.

**ELEVATOR LAB**

Elevator Lab is a leading FinTech accelerator built by Raiffeisen Bank International AG (RBI) to jointly develop scalable business cases. It offers access to 14 Central and Eastern Europe markets and a global network of clients, business partners, and investors.

**Venture capital and debt**

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

In light of the changes to the tax exemptions granted to MiFiGs, limited partnerships (Kommanditgesellschaft) are likely to become increasingly popular for VC funds. These are normally structured as a limited partnership with a GmbH as its general partner and the investors as limited partner. The general partner is excluded from management, which is provided by a separate management company with limited partner status. The respective management company is likely to be another GmbH (or legal person) as a matter of law, because the Alternative Investment Funds Manager Act (Alternative Investmentfonds Manager-Gesetz or AIFMG) requires the alternative investment funds manager to be a legal person.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.
CAPITAL MARKETS FUNDING

FinTech companies in Austria may issue bonds or securities either under the Alternative Financing Act (Alternativfinanzierungsgesetz or AltFG) or the Capital Market Act (Kapitalmarktgesetz or KMG) regime to obtain funding.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are as follows.

Transfer by way of assumption/acquisition of contract (Vertragsübernahme)

A loan transfer by way of assumption/acquisition of contract is a full legal transfer of the party's rights and obligations (subject to contractual restrictions such as required prior consent). It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

Assignment

An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment could be done without the consent of the debtor (however, it is advised to inform the debtor for purposes of effective payment).

Sub-participation

A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Loan transfers are commonly documented by using standard form contracts related to documents by the Loan Market Association (LMA) although Austrian templates deviate to some extent from the LMA standard documentation. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **license requirement** – under Austrian law a banking license pursuant to the Banking Act is required in order to purchase loan debt from another party;

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser, which is very limited and administered very strictly by the Austrian regulator (FMA) pursuant to Austrian Banking Secrecy Act (the purchaser would need to maintain the banking secrecy and basically requires the purchaser to be a credit institution or to obtain prior explicit consent from the debtor to waive the banking secrecy obligations);

- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in Austria can be divided into:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons).

Energy

Austria is one of the foremost producers of hydroelectric power in Europe. The most important power facilities are publicly owned; 50% of the shares of the large private producers are owned by provincial governments.

The Austrian upstream sector is dominated by two companies, OMV, a partly federal-state-owned company, responsible for approximately 15% of crude oil and natural gas liquids produced, and Rohöl Aufsuchungs AG (RAG), a privately owned company responsible for about 15% of crude oil and natural gas liquids production. OMV is the operator of Austria's only refinery in Schwechat. RAG focuses on drilling technology and large-scale gas storage, boasting 70% of the Austrian annual gas demand.

Currently, the Austrian Federal State, namely the Austrian Industry Holding AG has a stake of 31.5% in OMV.

The existing Austrian transit pipelines are (at least partly) owned and operated by GCA, a subsidiary of OMV (51%) and a consortium consisting of Allianz and Snam S.p.A. (49%).

Telecoms infrastructure

The Austrian mobile phone market is characterized by a high share of mobile broadband, paired with an average take-up of fixed broadband. The telecommunications networks (fixed and mobile) are privately owned by a number of service providers. Austria has a highly developed and efficient telephone network and a number of radio and television broadcast stations. There are three nationwide GSM networks which also support additional brands and mobile virtual network operators (MVNOs).

Transport infrastructure

LIGHT RAIL

Typically, light rail assets (such as trams, buses and metros) are owned by local public sector promoting bodies.

Wiener Linien runs the largest part of the public transit network in the city of Vienna.

HEAVY RAIL

The rail market in Austria is privatized, however, shares are held by both public and private entities.
Österreichische Bundesbahnen (ÖBB) is the national railway system of Austria and the administrator of Liechtenstein's railways. The ÖBB group is owned entirely by the Republic of Austria and is divided into several separate businesses that manage the infrastructure and operate passenger and freight services.

ROADS, BRIDGES AND TUNNELS

The Autobahnen- und Schnellstraßen-Finanzierungs-Aktiengesellschaft (ASFiNAG) is an Austrian publicly owned corporation which plans, finances, builds, maintains and collects tolls for Austrian roads, bridges and tunnels. The ASFiNAG and is fully owned by the Austrian Republic.

AVIATION

Aviation is for the most part privatized. The Vienna International is the country's biggest airport and serves as the hub for Austrian Airlines and a base for Eurowings and Niki. Austrian Airlines is the largest subsidiary of German Lufthansa. It is one of the few publicly traded airport operators in Europe and was privatized in 1992.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector with the private's sector's responsibility being for any or all of the design, build, financing, operation and maintenance of the infrastructure.

EDUCATION

The Republic of Austria has a free and public school system and nine years of education are mandatory. The federal Ministry of Education is responsible for funding and supervising primary and secondary education, and since 2000, tertiary education enjoys partial autonomy.

HEALTHCARE

Austria has a healthcare system in which virtually all individuals receive publicly funded care, but they also have the option to purchase supplementary private health insurance. Some individuals choose to pay for all of their care privately.

DEFENSE

The Austrian Armed Forces (German: Österreichisches Bundesheer) is the military of the Republic of Austria and is divided into Joint Forces which consist of Land Forces, Air Forces, International Missions and Special Forces.

WASTE

Vienna's municipal waste management system is the largest waste disposal company of Austria. The Federal Waste Management Act provides the legal framework for waste management and regulates all matters pertaining to waste as well as all issues requiring uniform federal provisions.

WATER

The largest operator of the entire water supply is the Municipal Department 31 of the municipality of Vienna, which is responsible for operation and maintenance.

Are there special rules for investing in energy and infrastructure?

Generally

Austria's energy policy rests on three pillars – security of supply, energy efficiency and renewable energy sources. In this regard it is important to mention the Außenwirtschaftsgesetz (Foreign Trade Act) which implements the requirements of EU law and creates a balance between sufficient control standards and a high degree of user friendliness. Its main regulatory areas consist of export control, control of
transport of defense equipment within the EU and control of the takeover of Austrian companies by persons or companies from third countries (outside EU, EEA, Switzerland).

Energy

Austria's energy legislation is fairly comprehensive, with one central act (Mineral Resource Act 1999) regulating oil and gas exploration and production as well as general mining activities at the federal state level. The administrative role is centralized, with the Ministry (for Sustainability and tourism) being responsible for the performance of a great deal of administrative duties in the upstream sector.

The Mineral Resource Act 1999 is applicable to the entire federal state. Austria has had to implement a number of directives that apply to the upstream energy sector. The Oil and Gas Directive, which aims to ensure non-discriminatory access to oil and gas exploration and production. Austria is also a part of the internal market for gas, having implemented the European Third Energy Package, which aims to liberalize the European natural gas market. In addition to the European Directives, the reporting provisions of the Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) have a direct effect on Austrian gas market participants. Furthermore, Austria is a signatory to the Energy Charter Treaty, which aims to facilitate trade between the signatory states.

Austria has entered into several bilateral agreements on energy matters, the most notable being with the Russian Federation regarding the cooperation in the construction of the South Stream gas pipeline connection. In addition, Austria has entered into bilateral agreements with Czech Republic and Slovakia, regarding cooperation in oil and gas exploration.

Furthermore, the Austrian national regulatory authority, E-Control, was created in 2001 when the market was liberalized. In line with a key objective of the Third Package, E-Control's powers have been augmented with the 2010 E-Control Act, which consolidates all regulatory power under one entity.

Telecoms infrastructure

Austria has invested heavily in expanding its telecommunications infrastructure (Telekommunikationsgesetz 2003) compared to other EU member states. Companies in Austria can take advantage of state-of-the-art, high-capacity networks and systems. Rules for investing are stated in paragraph 25a of the Foreign Trade Act 2013. As far as EU or international law provisions do not preclude a licensing requirement, any process regarding telecommunications requires the authorization from the Federal Minister for Economic Affairs, Family and Youth.

Transport infrastructure

RAIL

Rail transport in Austria is mainly owned by the national rail company Österreichische Bundesbahnen (ÖBB).

ROADS

National highways in Austria are maintained by the Federal Agency of the Transport Ministry. In order for a private sector partner to carry out its duties on certain types of roads projects, the procuring public sector authority may delegate certain of its statutory duties to a private sector partner. Another possibility is to arrange public-private partnerships which are typically cooperative arrangements between one or more public and private sectors, typically of a long-term nature.

Other infrastructure

Demand is also rising in Austria for electric-powered vehicles, electric vehicle charging stations and charging points. The number of e-vehicles is expected to increase in the coming years. As of March 2017, there are Austrian premiums granted for the purchase of electric vehicles.

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What is the applicable procurement process?

Austria's public procurement system is quite streamlined and efficient as a result of a simple and stable regulatory framework. Although public procurement is carried out at all different levels of government, an important share of purchases is centralized by the Federal Procurement Agency (BBG), which plays a central role in the efficiency and harmonization of public procurement procedures as well as in
Investing in energy and infrastructure

For the state (Bund) and public bodies on the central government level, the Federal Public Procurement Law 2018 (Bundesvergabegesetz 2018 – BVergG 2018) implements Directives 2004/17/EC and 2004/18/EC (aspects on content) as well as Directives 89/665/EEC and 92/13/EEC (review proceedings).

First, the BVergG 2018 provides for the legal framework for the award of public works, supply and service contracts as well as works and service concessions and contests (the 'classic regime'). Second, it contains regulations coordinating the public procurement procedures of entities operating in the water, energy, transport and postal services sector (the 'sector regime'). Under both regimes, it covers public tenders above and below the thresholds of Regulation (EC) 2083/2005. Third, the BVergG 2018 comprises procedural provisions relating to the review of the award of public contracts.

- **'Open procedures’** are those procedures in which any economic operator may submit a tender.

- **'Restricted procedures with publication of a contract notice (classic regime)/with calling for a competition (sector regime)'** are those procedures in which any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender.

- **'Negotiated procedures with publication of a contract notice/with calling for a competition’** are those procedures in which any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender and whereby the contracting authority negotiates the terms of contract with those tenderers.

- **'Negotiated procedures without publication of a contract notice/without calling for a competition’** are those procedures whereby the contracting authority invites certain candidates to submit an offer and then negotiates the terms of contract with the selected tenderers.

- **'Dynamic purchasing systems’** are completely electronic processes for making commonly used purchases, the characteristics of which, as generally available to the market, meet the requirements of the contracting authority.

- A **'competitive dialogue’** is a procedure in which any economic operator may request to participate and whereby the contracting authority conducts a dialogue with the candidates admitted to that procedure, with the aim of developing one or more suitable alternatives capable of meeting its requirements and on the basis of which the candidates chosen are invited to submit a bid.

- **'Design contests’** are those procedures which enable contracting authorities to acquire, mainly in the fields of town and country planning, architecture and engineering, advertisement or date processing, a plan or design selected by a jury after being put out to competition with or without the award of prizes. Such contests can be either open, restricted or invited contests.

- **'Realization contests’** are contests which lead to a negotiated procedure to award a public service contract after carrying out a design contest.

- Innovation Partnership can be chosen if there is a need for an innovative product, construction or service. This procedure is only applicable, if the demand cannot be met by acquiring goods or services already available on the market.

Financing energy and infrastructure

Fundamentally, the BVergG 2018 covers all types of contracts whether their estimated value is above or below the EU thresholds. Thresholds are set for different tender procedures, with more formalized and transparent procedures applying where the estimated value of the public contract exceeds a threshold of currently EUR100,000 excluding VAT.

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**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis;
loans made on a project-finance basis on medium- to long-term bases;

- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing.

The Green Electricity Act 2012 expanded the number of facilities producing green electricity. As a result, funding volume doubled to about EUR50 million, granted by the Austrian government and approved by the European Commission. This offensive is designed to boost the share of electricity consumption generated by renewables to 85% by the year 2020.

Investing

Common forms of investing in energy and infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

If the Financial Market Authority considers that an authorized firm or regulated individual may have breached its ongoing compliance requirements under applicable regulations, it will launch a formal investigation. This may result in regulatory sanctions.

What regulatory penalties may apply?

Consequences of conducting regulated activities (eg a banking business) when not authorized include:

- Financial Market Authority may impose a financial penalty; and
- loss of business-related remunerations, commissions earned and interest.

What criminal penalties may apply?

Following a formal investigation, the regulators and Austrian courts have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- disclosure of facts covered by a bank's duty of confidentiality in order to receive a financial benefit;
- breaches of the Money Laundering Regulations; and
- conducting regulated activities when not authorized.
Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

ADVANCE OF A LOAN

The advance of a loan is not subject to stamp, registration, transfer or other similar taxes.

TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN

A written agreement for the assignment of a debt is subject to stamp duty in the amount of 0.8% of the consideration for the assignment. However, exemptions may apply.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

A written mortgage agreement is subject to stamp duty in the amount of 1% of the debt for which the mortgage is granted. In addition, accessory guarantees are subject to stamp duty in the amount of 1% of the debt for which the guarantee is granted. However, if the mortgage or accessory guarantee is granted in respect of a loan, these securities are exempt from stamp duty.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

ISSUE OF A DEBT SECURITY

The issue of a debt security is not subject to stamp, registration, transfer or other similar taxes.

TRANSFER OR ASSIGNMENT OF A DEBT SECURITY

The transfer or assignment of a debt security may be subject to stamp duty in the amount of 0.8% of the consideration for the assignment.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

No.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

In general, interest payments under a loan are subject to withholding tax. However, if the loan is a between two individuals, the interest payments are not subject to withholding tax.
If so:
What is the rate of withholding?

The withholding tax rate is 27.5%.

What are the key exemptions?

If the loan is between two individuals, the interest payments are not subject to withholding tax.

An exemption is available under the EU Interest and Royalties Directive as implemented in Austria.

An exemption may also be available (in whole or in part) under an Austrian double tax treaty where applicable.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes, interest payments on debt securities are also subject to withholding tax as described above.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Oskar Winkler
Partner
DLA Piper Weiss-Tessbach Rechtsanwälte GmbH
oskar.winkler@dlapiper.com
T: +43 1 531 78 1019
Belgium

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Both Belgian and EU law contain restrictions on offering and selling debt securities.

Unless certain exclusions or exemptions apply, the public offer of debt securities in Belgium and the admission of such securities to trading on a Belgian regulated market requires the publication of a prospectus in compliance with the Prospectus Regulation/Prospectus Law.

A prospectus shall, in particular, not be required for public offers of securities or other investment instruments that are either:

- For a total consideration of less than, or equal to, EUR5,000,000.

- For a total consideration of more than EUR5,000,000 and less than, or equal to, EUR8,000,000,000 which will be admitted to trading on Euronext Growth Brussels or Euronext Access Brussels.

However, any prospectus drawn up in respect of investment instruments (other than securities) will not benefit from the EEA passporting regime.

The Prospectus Law also requires issuers to prepare an "information note" in the following circumstances (in each case, subject to certain exemptions):

- An offer to the public of securities or other investment instruments for a total consideration of less than EUR5,000,000.

- An offer to the public of securities or other investment instruments for a total consideration of less than EUR8,000,000,000 to the extent these instruments will be listed on Euronext Growth Brussels or Euronext Access Brussels.

- An admission to trading of securities or other investment instruments on Euronext Growth Brussels or Euronext Access Brussels.

This obligation does not apply to the following offers (the so called ‘safe harbor provisions’):

- an offer for a total consideration of less than, or equal to, € 5,000,000;

- an offer for a total consideration of more than € 5,000,000 and less than, or equal to, € 8,000,000,000 which will be admitted to trading on Euronext Growth Brussels or Euronext Access Brussels.

What are common issuing methods and types of debt securities?
The most common types of debt securities issued in Belgium are bonds or notes issued on a standalone basis or under a program. Many different types of debt securities are offered in Belgium. Some common forms include:

- Debt securities characterized by the type of interest or payment such as fixed rate securities, floating rate securities, variable rate securities, and high yield bonds;
- Guaranteed securities, subordinated securities, perpetual debt securities (i.e., debt securities that have no specified redemption date);
- Asset backed securities;
- Derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit linked notes;
- Equity linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- Depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- Warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

What are the differences between offering debt securities to institutional / professional or other investors?

If the debt securities are offered solely to professional investors and no admission to trading on a regulated market of the debt securities is sought, no prospectus would be required, in line with the Prospectus Regulation/Law.

The issuer prepares an offering circular with certain information on the issuer and the securities offered, without FSMA approval.

The Belgian Prospectus Law however requires issuers in certain circumstances to prepare and publish a short-form information note which complies with the minimum information requirement set out in the Prospectus Law.

An offer to the public (retail issue) of debt securities is made under a placement agreement entered into before the offering period starts. In principle, a prospectus must be prepared, and it must be approved by the FSMA.

When is it necessary to prepare a prospectus?

Offers to professional investors require issuers in certain circumstances to prepare and publish a short-form information note which complies with the minimum information requirement set out in the Prospectus Law. A prospectus must be prepared in case of admission to trading on a regulated market.

An offer to the public of debt securities requires in principle a prospectus.

What are the main exchanges available?

Euronext Brussels is a regulated market for the purposes of the Markets in Financial Instruments Directive, so issuers are subject to the requirements of a number of EU Directives, including the Market Abuse Directive and the Transparency Directive.

Euronext Growth is the main multilateral trading facility (MTF) in Belgium.

Is there a private placement market?
Belgium has a private placement market.

There is no dominant standard for documentation but the standard private placement documentation developed by the Loan Market Association and International Capital Markets Association are often used.

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**Are there any notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Belgian law. Belgium provides investor protection through legal and regulatory provisions relevant to liability for an inaccurate offering memorandum.

There are also general fraud laws and regulations and liability may also arise through a civil action for deceit, negligent misstatement or misrepresentation.

**Investing in debt securities**

Debt security terms and conditions typically provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

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**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**

The AIFM Law provides a regulatory framework for alternative investment fund managers (AIFM) governed by either Belgian law or the laws of an EEA or non-EEA member state that are managing alternative investment funds (AIF) governed by Belgian law or marketing EEA or non-EEA AIFs in Belgium.

The Alternative Investment Fund Managers Directive (AIFMD) only applies to the (external or internal) AIFMs but it provides each member state with the option to also regulate on a national level the AIFs established in such member state. The Belgian legislator opted to keep the existing legislation with respect to public and specific non-public AIFs (including their managers) and to restate this legislation (with certain modifications) into the AIFM Law. The AIFM Law's scope is therefore broader than the AIFMD.

In line with the AIFMD, certain types of funds are excluded from the AIFM Law's scope of application. These include Undertakings for Collective Investment in Transferable Securities (UCITS), holding companies, institutions for occupational retirement provision and securitization special purpose entities.

The AIFM Law lays down a broad set of rules regarding, among other things, authorization, operating conditions (for example, rules on remuneration, conflicts of interest, risk management, liquidity management, valuation, delegation and acting as a depositary), transparency requirements for AIFMs (annual report, disclosure to investors, and reporting obligation to competent authorities) and special obligations for AIFMs managing specific types of AIFs, such as leveraged AIFs or AIFs which acquire control of non-listed companies and issuers (notification, disclosure, annual report, asset stripping). Furthermore, the AIFM Law contains a passport mechanism for management and/or marketing for EEA AIFMs managing or marketing EEA AIFs. The AIFM Law provides for a 'light regime' whereby certain smaller AIFMs (e.g., Belgian private equity fund managers) will not have to comply with the requirements under the AIFM Law unless they choose to opt in.

The UCITS Law provides a regulatory framework and introduces a simplified notification procedure for UCITS that wish to market their units in member states other than those in which they are established.
The UCITS Law provides certain obligations that must be taken into account, such as the publication of a prospectus and the prior approval of advertising materials and a key investor information document by the Financial Services and Markets Authority (Autorité des services et marchés financier/Autoriteit voor Financiële Diensten en Markten) (FSMA). The public offering of a UCITS also triggers an obligation to register the UCITS with the FSMA.

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**What are common fund structures?**

They can (irrespective of legal form) take a closed ended or open ended form, so there may be four basic forms (either UCITS or AIFs):

- contractual funds with variable capital;
- contractual funds with fixed capital;
- companies with variable capital (SICAVs); and
- companies with fixed capital (SICAFs).

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**What are the differences between offering fund securities to professional / institutional or other investors?**

EU based alternative investment fund managers (AIFMs) authorized under the AIFM Law will be granted a passport to either manage alternative investment funds (AIFs) in other EU member states or to market the units or shares of AIFs in other EU member states to professional investors. In order to exercise such activities in other EU member states, the EU based AIFM is required to notify the supervisory authority of the relevant member state.

The passport regime will not apply to the marketing of AIF units or shares to retail investors, as the Alternative Investment Fund Managers Directive (AIFMD) permits the member states to impose stricter requirements for marketing to such investors. As is the case in most EU member states, Belgium has elected to make use of this option, and the AIFM Law imposes more stringent conditions for AIFMs marketing units or shares in AIFs to retail investors.

For the purposes of the AIFMD, the term 'professional investors' is defined as any investor that is considered as, or may be treated as, a professional client under the Markets in Financial Instruments Directive (MiFiD). Professional clients include, among other things, credit institutions, investment firms and collective investment schemes, as well as 'opted up' retail clients.

The UCITS Law contains rules applicable to Belgian Undertakings for Collective Investment in Transferable Securities (UCITS) and foreign UCITS complying with the conditions of the Undertakings for Collective Investment in Transferable Securities Directive, whose shares are offered to the public in Belgium.

The UCITS Law is not applicable to foreign UCITS whose shares are offered within the context of a private placement. In derogation from the UCITS Directive, the UCITS Law further distinguishes between Belgian UCITS whose shares are offered within the framework of a public offering and Belgian UCITS whose shares are offered within the framework of a private placement. There is no public offer if the shares are exclusively offered to professional investors.

Publicly offered UCITS are subject to a list of additional requirements, such as a registration with the FSMA. Moreover, all communications, advertisements and other documents that are related to a public offering of the shares in a UCITS must be pre-approved by the FSMA and must be complete, accurate and consistent with the prospectus.

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**Are there any other notable risks or issues around establishing and investing in funds?**

N/A

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

The marketing of funds is generally covered under the Undertakings for Collective Investment in Transferable Securities (UCITS) or under the Alternative Investment Funds Managers Directive (AIFMD) regime.

UCITS, including those established in Belgium, have an EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor information documents. The home regulator then completes a notification file which is sent in a regulator to regulator transmission, following which the UCITS can be sold in the other member state.

Under AIFMD, marketing is defined as a direct or indirect offering or placement at the initiative of AIFM or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).

As the AIFMD’s passport regime for the marketing of non-EU AIFs by EU AIFMs and the marketing of AIFs by non-EU AIFMs, is not yet available, Articles 36 and 42 of the AIFMD allow the member states to permit such marketing if certain conditions are met. The Belgian legislator has decided to implement Articles 36 and 42 of the AIFMD. The private placement regime is therefore still available in case a passport is not yet available.

In accordance with Article 68 of the AIFMD, these grandfathering rules and the private placement regime in Belgium will be abolished on a date to be determined by the European Commission. It is expected that this abolition will not take place before the end of 2018.

In addition to these two laws, a number of other regulations have impacted the way that funds can be distributed in Belgium. These include the:

- Belgian moratorium on the marketing of particularly complex products to non-professional clients (which prohibits or limits the marketing of certain funds by distributors that have acceded to the moratorium);
- Royal Decree of 25 April 2014 on certain information requirements when marketing financial products to non-professional clients (which adopts a ‘transversal’ approach towards financial products); and
- Royal Decree of 24 April 2014 approving the regulation of the FSMA on the ban on the distribution of certain financial products to retail clients.

Are there any restrictions on managing a fund?

Alternative Investment Fund Managers (AIFM)/Undertakings for Collective Investment in Transferable Securities (UCITS) management companies are subject to prior authorization to be granted by the competent authorities of the management company’s home member state. Authorization granted to a management company shall be valid for all member states. A management company that does not benefit from an exemption pursuant to the AIFM/UCITS Law will need to obtain authorization from its home regulator (the Financial Services and Markets Authority (Autorité des services et marchés financiers/Autoriteit voor Financiële Diensten en Markten) (FSMA) in Belgium) in order to manage AIFs/UCITS. As part of the application procedure, the management company will need to provide certain information to the regulator.

Before granting an authorization to a management company, the FSMA may be required to consult with other member state regulators (for example, if the management company in question is associated with an entity regulated in another member state, such as an investment firm, a credit institution or an insurance undertaking).
Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in Belgium (such as investment firms) will in principle have to be authorized.

The distribution of certain financial derivatives among Belgian retail clients is restricted as from 18 August 2016. Certain derivatives such as binary options or contracts for difference (CFDs) with leverage, may not be distributed, and certain distribution practices are also prohibited. The Regulation drawn up by the Financial Services and Markets Authority (Autorité des services et marchés financiers/Autoriteit voor Financiële Diensten en Markten) (FSMA) on this matter was approved by Royal Decree of 21 July 2016 that approves the FSMA’s Regulation on the distribution of over-the-counter (OTC) derivatives (Regulation). The Regulation applies to derivative contracts distributed to consumers in Belgium, usually from abroad, via electronic trading platforms.

The Regulation consists of two elements which apply cumulatively:

- The first element is a ban on distribution of a few specific types of derivative contracts to consumers via electronic trading platforms. These are binary options, derivative contracts with a maturity of less than 1 hour, derivative contracts with leverage, such as CFDs and rolling spot forex contracts. The Regulation applies to unlisted or OTC derivatives. It does not apply to derivatives that are admitted to trading on a regulated market or on a multilateral trading facility. The Regulation supplements the distribution ban that was already in force for certain products, such as life settlements (traded life policies) and financial products with a virtual currency as their underlying.
- The second element is a ban on a number of aggressive or inappropriate distribution techniques (cold calling via external call centers, inappropriate forms of remuneration, fictitious gifts or bonuses etc) used when distributing OTC derivatives to consumers.

In addition, the European Market Infrastructure Regulation (EMIR) imposes obligations on EU derivatives market participants. EMIR applies to financial counterparties (banks, investment firms, insurance companies, registered funds (UCITS), pension funds and private funds) and non financial counterparties (any other undertaking established in the EU) that enter into derivatives, whether they do so for trading purposes, to hedge themselves against interest rate or foreign exchange risk or to gain exposure to certain assets as part of their investment strategy.

Certain EMIR obligations (clearing and risk mitigation) may also affect non EU entities in two sets of circumstances: EMIR can apply directly to those companies or indirectly impact them when they enter into derivatives with EU participants.

EMIR does not impose any new authorization or registration requirements for parties to derivatives contracts. EU dealers in OTC derivatives are already required to be authorized as investment firms under MiFID, unless an exemption applies.

EMIR imposes three main obligations on market participants:

- **Clearing** – Certain OTC derivatives entered into between certain market participants will have to be cleared via a central counterparty (CCP).
- **Reporting** – All derivatives (OTC and exchange traded, including derivatives entered into since, or that were outstanding on, 16 August 2012) will have to be reported to a trade repository.
- **Risk mitigation techniques** – OTC derivatives entered into between certain market participants and which are not cleared via a CCP are subject to risk mitigation obligations.

EU non financial counterparties that have 'systemically important' positions in 'non hedging' derivatives (whether at entity or group level) on any given day also have a notification obligation to their national competent authority and the European Securities and Markets Authority (ESMA).

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What are common types of derivatives?
The definition of ‘derivative’ is not set out in full in the European Market Infrastructure Regulation (EMIR) but cross refers to a sub set of financial instruments listed in the Markets in Financial Instruments Directive (MiFID).

Broadly speaking, a ‘derivative’ includes any option, future, swap, forward and other derivative contract relating to securities, currencies, interest rates, financial indices, commodities, financial contract for differences and credit default swap. This definition is, however, limited to bilateral derivative contracts, such as exchange traded derivatives (ETDs) and over-the-counter (OTC) contracts and does not, as a rule, include derivatives embedded in other contracts, such as securities or loans.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007 to 2008, derivatives, and particularly over the counter derivatives, have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over the counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen, and continues to see, the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is a regulated activity in relation to mortgage credit and consumer credit (Book VII of the Code of Economic Law).

Assuming none of the available exemptions apply, mortgage and consumer credit providers need to be authorized by the FSMA to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage and consumer contracts, specific obligations apply with respect to:

- conduct of business rules;
- provision of information;
- knowledge of the client/borrower; and
- assessment of the creditworthiness of the client/borrower.

There are no additional restrictions that apply to foreign lenders making loans to Belgian borrowers.

Providing financing to a company (excluding providing consumer credit and mortgage credit to individuals for residential purposes) (“commercial lending”) on a stand-alone basis does not require a licence nor any filing and/or registration.

However, specific rules of conduct apply for lending to SMEs, pursuant to the Act of 21 December 2013 on the Financing of SMEs. These rules of conduct include a duty of rigour, a duty of information, restrictions on a number of contractual terms, and a right of prepayment.
for the enterprise. SMEs are individuals or legal entities pursuing an economic purpose in a sustainable manner or liberal professions (eg, lawyers, notaries, etc) that have no more than one of the following criteria in their last and penultimate closed financial year: (i) 50 employees on an annual basis; (ii) annual turnover of EUR9 million; and (iii) a total balance sheet of EUR4.5 million.

Commercial lending sometimes activity requires a licence – ie, if it is undertaken in combination with deposit taking (which requires a licence as a credit institution) or if it is funded with crowdfunding (which may require a licence as a crowdfunding platform).

**Borrowing**

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

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**What are common lending structures?**

Lending in Belgium can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities or letter of credit facilities.

**Loan durations**

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short term basis to solve short term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, see _Giving and taking guarantees and security._

**Loan repayment**

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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**What are the differences between lending to institutional / professional or other borrowers?**

There are no differences except for mortgage credit and consumer credit, which are regulated activities.
Do the laws recognize the principles of agency and trusts?

The principle of agency is recognized as a matter of Belgian law. It is possible to appoint an agent, who would act in the name and for the account of a single regulated undertaking (as opposed to a broker).

It also explicitly recognises the concept of a collateral agent/security agent, but only in relation to security taken over financial collateral and movable assets. This allows for the creation of security over such assets for the benefit of the agent (acting as representative of the secured parties), provided that the secured parties are determinable on the basis of the security agreement.

However, Belgian law does not recognise the concept of a security agent with respect to security over real estate. Therefore, when a mortgage is being granted to a security agent on behalf of a consortium of lenders, or in a situation where there is only one lender but the intention is to subsequently syndicate the facilities, a parallel debt structure can be considered. Although Belgian law does not recognise the concept of parallel debt as such, the use thereof has been common practice, and the concept and validity thereof has been supported by Belgian legal authors.

Belgian law does not recognize the principle of trusts. Belgian Courts would, however, recognize foreign trusts validly incorporated to the extent that they are not manifestly incompatible with Belgian mandatory laws.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. For example, Belgian courts may decide not to enforce a penalty or may decide to reduce the agreed amount. Lenders hence have to be careful about the rate of default interest charged on a loan.

Specific types of lending

Specific to the area of mortgage lending is the issue of whether a lender falls within the new Belgian mortgage regime. The Mortgage Credit Directive, implemented in Belgium through the law of 22 April 2016 amending the provisions on consumer credit and mortgage credit in the Code of Economic Law, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Law imposes a number of requirements on lenders including the need to:

- assess the creditworthiness of the consumer;
- provide the consumer with the personalized information needed to compare the credits available on the market; and
- ensure that the relevant staff of creditors, credit intermediaries and appointed representatives possess an adequate level of knowledge and competence, in order to achieve a high level of professionalism.

Consumer credit is regulated in the Code of Economic Law. The Consumer Credit Directive (2008/48/EC) was implemented in Belgian law by the Act of 13 June 2010 and amended by the law of 22 April 2016 amending the provisions on consumer credit and mortgage credit in the Code of Economic Law. The Law also imposes a number of requirements on credit providers.

Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU’s Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.
Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. ‘Bail in’ describes a variety of write-down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Belgian or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Furthermore, when a borrower, security provider or guarantor becomes insolvent, the related claims and security rights of lenders might lose value, because the lenders need to compete with other privileged creditors or the collateral is insufficient to cover the total debt. In addition, enforcement might be delayed or no longer possible.

In the case of bankruptcy, any payments or security granted to lenders might also become subject to claw-back actions, upon the opening of insolvency proceedings.

Certain transactions may be declared ineffective vis-à-vis third parties if they are concluded or performed by the debtor during the hardening period (a period of up to a maximum of six months prior to the date of the bankruptcy judgment). There is an exhaustive list of automatic and non-discretionary claw-back events, as follows:

- gifts and undervalued contracts;
- payments made for amounts that are not due at the date of payment;
- new security granted for existing debt; and
- all other payments made to creditors.

These can be challenged by the bankruptcy receiver if the creditor that accepted payment was aware of the financial distress of the company at the time of the event.

In addition, at the request of the bankruptcy receiver, the court can declare other transactions that have been entered into or performed during the hardening period ineffective, provided the counterparty was aware of the fact that the debtor was virtually bankrupt and the court determines that this declaration would benefit the bankruptcy estate (ie, the challenged transaction was detrimental to the rights of the creditors).

Moreover, “fraudulent transactions” (ie, abnormal transactions that are detrimental to the rights of the creditors and where there is fraud on the part of both the debtor and the other party) can be declared ineffective, regardless of whether they occurred during or before the hardening period.

If the lender acts as a credit institution, it has an obligation to inquire about its client's ability to repay his debt, and must evaluate the validity of the securities granted to him. If the institution does not comply with that provision, it may be ordered to reimburse the sums resulting from the call on the guarantee or the enforcement of the securities.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

The main issues involved in a company granting any downstream, upstream or cross-stream guarantee/security in respect of any obligation of a company belonging to the same group concern the existence of a valid and direct corporate benefit for that subsidiary. Under Belgian law there is no legal concept of group interest and only showing that the security would be in the interest of the group is not sufficient.

The granting of an intra-group guarantee/security must also fall within the corporate purpose of that company. The corporate purpose of a Belgian company is set out in its articles of association and Belgian companies can only act within the boundaries of this corporate purpose.

In the context of a target being acquired, the target is restricted from granting guarantees or security (financial assistance) for the acquisition of its own shares. However, this can be permitted following the adoption of a particular procedure. Given the cumbersome nature of such procedure, it is not common that companies choose to comply with the procedure and they will usually structure a
transaction avoiding financial assistance.

Other conditions and/or restrictions depend on the type of guarantees/security.

All security interests under Belgian law can be created by means of a private agreement, except mortgages and mortgage mandates that must be created by means of a notarial deed and, in case of a mortgage, registered at the competent mortgage registry.

**General validity requirements that are applicable to all agreements**

- Consent of the parties
- Capacity of the parties
- Determination of the object of the security taking (a determined or determinable asset)
- Legitimate cause (the cause of the agreement must not be prohibited by law or contrary to morals and public order)
- In the case that security is granted by an individual – restrictions on security granted without consideration and limitations resulting from the marital status (which may require spousal consent)
- In the case that security is granted by a legal entity – authorization by the competent bodies, conformity with corporate interest, no violation of specific restrictions (eg financial assistance rules or prohibition on ‘misuse’ of corporate assets

**Specific validity requirements**

- **Mortgages** – formal notarial deed, secures a specific amount, must accurately define the mortgaged real estate
- **Register pledge** – all moveable assets, tangible and intangible, in whole or in part, can be pledged by private agreement (a register pledge will be valid between the parties to it from the date it is concluded but, in order to be valid and enforceable against third parties, the pledge should be registered in the yet to be established National Pledge Register)
- **Pledge over receivables** – effected by private agreement (under Belgian law, a pledge over receivables is valid between parties and enforceable against third parties (other than the debtor of the receivables) as from the date of its conclusion; in order to be valid and enforceable against the debtors of the receivables the debtors must be notified of the pledge)
- **Pledge over bank account** – an acknowledgement by the bank holding the pledged accounts is required in order to protect the pledgee against risks arising out of rights afforded to the bank pursuant to its standard account terms and conditions or otherwise
- **Pledge over shares** – articles of association must be reviewed, may contain restrictions to the granting of a pledge over shares; pledge needs to be registered in the shareholders register of the company

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**What are common types of guarantees and security?**

The most common forms of guarantees and security are:

- security interest *in rem*:
  - pledge over tangible assets
  - pledge over receivables, bank accounts, securities or business);
  - title transfer as security interest;
  - mortgage over real estate;
  - mortgage mandate (however, the mortgage mandate does not provide for an actual security right on the assets but only gives the right to establish a mortgage at a later point in time);
  - security interest over ships and planes; and
- personal security interest – a third party (such as a guarantor) will secure the claim of the creditor on the debtor, by committing its estate or by granting one of the security interests listed above.
Are there any other notable risks or issues around giving and taking guarantees and security?

All sums security interests

A security interest on conditional or future debts is valid under Belgian law as long as the future debt is sufficiently determined or determinable which is the case if the agreement creating the security interest allows to define and identify the debt, and it results from the elements of the cause that the (future) debt was part of what the parties intended to secure.

Mortgages

Mortgage requires registration of the mortgage with the appropriate local mortgage register for it to be effective vis-à-vis third parties.

Other

Other security interests may require specific perfection requirements.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Relevant EU legislation

BANKING SUPERVISION

Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms


FINANCIAL MARKETS AND INVESTMENT SERVICES

The Markets in Financial Instruments Directive (Directive 2014/65/EU; "MiFID II")

Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits; and Regulation on markets in financial instruments (Regulation n° 600/2014; "MiFIR")


Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC

INSURANCES


REGULATED CREDIT AND CONSUMER PROTECTION


Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features


PAYMENT SERVICES


INVESTMENT FUNDS


POST TRADE


Relevant Belgian legislation
BANKING SUPERVISION

Law of 25 April 2014 on the legal status and supervision of credit institutions and stockbroking firms

FINANCIAL MARKETS AND INVESTMENT SERVICES

Law of 21 November 2017 on infrastructure for markets in financial instruments and on the implementation of Directive 2014/65/EU

Law of 2 August 2002 on the supervision of the financial sector and on financial services

Law of 11 July 2018 on public offers of investment instruments and the admission to trading of investment instruments on regulated markets

INSURANCE AND REINSURANCE

Law of 13 March 2016 on the legal status and supervision of insurance or reinsurance undertakings

Law of 4 April 2014 on insurance

REGULATED CREDIT AND CONSUMER PROTECTION

Book VI (Market Practices and consumer protection) of the Code Economic Law

Book VII (Payment Services and Credit) of the Code Economic Law

Royal Decree of 25 April 2014 on certain information requirements in relation to marketing of financial products with non-professional client

PAYMENT SERVICES

The Law of 11 March 2018 on the statute and supervision of payment institutions and electronic money institutions, access to the business of payment service provider and to the activity of issuing electronic money, and access to payment systems.

Book VII (Payment Services and Credit) of the Code Economic Law

INVESTMENT FUNDS

Law of 3 August 2012 on certain forms of collective management of investment portfolios (the UCITS Law)

Law of 19 April 2014 on alternative investment funds and their managers (the AIFM Law)

POST TRADE


Law of 15 December 2004 on financial collateral and containing various tax provisions in respect of collateral security agreements and loans of financial instruments

OTHER KEY LEGISLATIONS

The Law of 18 September 2017 on the prevention of money laundering and terrorist financing and on the restriction of the use of cash.

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Regulatory authorization

Who are the regulators?

Supervision is organized according to the ‘Twin Peaks’ model, with two autonomous supervisors, namely the National Bank of Belgium (Banque Nationale de Belgique/Nationale Bank van België) (NBB) and the Financial Services and Markets Authority (Autorité des services et
marchés financiers/Autoriteit voor Financiële Diensten en Markten) (FSMA), each of which has a specific set of objectives.

The NBB performs macro prudential supervision of ‘system relevant’ financial institutions and is also responsible for the individual prudential supervision (including compliance with anti-money laundering legislation) of financial institutions authorized to hold funds on behalf of their clients.

The FSMA is the supervisor with respect to financial markets, investment products and the rules of conduct that apply to financial institutions. It is also responsible for contributing to the financial education of savers and investors.

Beside the national authorities, the European Central Bank (ECB) is the competent authority in Belgium for carrying out its micro-prudential tasks within the single supervisory mechanism (SSM) under Regulation (EU) No 1024/2013 in respect of Belgian credit institutions and (mixed) financial holding companies that are classified as significant. The ECB is also the competent authority to authorize these institutions and to withdraw their authorizations subject to the relevant provisions laid down in Regulation No 1024/2013.

**What are the authorization requirements and process?**

A financial institution is required to obtain an authorization before commencing any regulated activities, unless certain exclusions or exemptions apply. Depending on the type of firm, a firm must apply to the National Bank of Belgium (Banque Nationale de Belgique/Nationale Bank van België), European Central Bank or the Financial Services and Markets Authority (Autorité des services et marchés financier/Autoriteit voor Financiële Diensten en Markten) for authorization.

- Credit institutions/stockbroking firms: NBB
- Insurance and reinsurance undertakings: NBB
- Payment institutions and electronic money institutions: NBB
- Settlement and clearing institutions: NBB
- Consumer/mortgage credit’ lenders: FSMA
- Portfolio management and investment advice companies: FSMA
- Intermediaries in banking and investment services: FSMA
- Platform of crowdfunding: FSMA
- Management companies of UCIT/AIF: FSMA
- Independent financial planner: FSMA

The authorization requirements and process depend on the institution concerned.

The competent authority must assess whether the application meets the required threshold conditions. Generally, in order to obtain an authorization, the institution needs to submit an application file which includes among other information:

- a program of operations;
- a business plan including a forecast budget calculation which demonstrates that the applicant is able to employ the appropriate and proportionate systems, resources and procedures to operate soundly;
- a description of the applicant’s governance arrangements and internal control mechanisms;
- a description of the applicant’s structural organization;
- the identity of persons holding in the applicant, directly or indirectly, qualifying holdings;
- the applicant’s legal status and articles of association; and
- the address of the applicant’s head office.

The applicant can only obtain a license if it is financially sound and meets the minimum initial capital and own funds requirements. These
What are the main ongoing compliance requirements?

Financial institutions must at all times comply with the authorization requirements. Threshold conditions (such as having adequate financial resources and structural and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and with the applicable laws and regulations can result in sanctions for the institutions concerned and can even lead to the revocation of the authorization.

Investment firms, management companies of undertakings for collective investment, undertakings for collective investment which have not designated a management company, credit institutions and insurance companies governed by Belgian law and the branches of such institutions established in Belgium governed by the laws of third countries, shall appoint compliance officers of good repute and with the requisite knowledge and experience with a view to ensuring compliance with the rules referred to in the laws.

What are the penalties for failure to be authorized?

Failure to be authorized may result in payment penalties, administrative or criminal sanctions.

Regulated activities

What finance and investment activities require authorization?

A person must not perform any regulated activities in Belgium unless authorized or exempt.

The following businesses would usually be deemed to be carrying on regulated activities and require authorization under Belgian law:

- credit institutions;
- investment firms: stockbroking firms, portfolio management or investment advice companies;
- insurance or reinsurance undertakings;
- payment institutions and electronic money institutions;
- settlement institutions and institutions equivalent to settlement institutions;
- consumer credit providers;
- intermediaries in banking and investment services;
- intermediaries in consumer credit and mortgage credit;
- intermediaries in insurance and reinsurance;
- Undertakings for Collective Investment in Transferable Securities (UCITS) and their management company; and
- Alternative Investment Funds (AIFs) and their management company.

Are there any possible exemptions?

For each type of regulated activity there are a number of specific exemptions that could also apply, such as the provision of investment
services on an ancillary basis.

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**Do any exchange controls or other restrictions on payments apply?**

Belgian law does not impose specific restrictions on exchange controls, except in exceptional situations (e.g., as with UN sanctions). Article 63 Treaty on the Functioning of the European Union (TFEU) expressly prohibits restrictions between EU member states and between member states and third countries.

Therefore, there are no exchange control rules for foreign investors and no restrictions on the repatriation of profits either. However, withholding tax (roerende voorheffing/précompte mobilier) may apply under certain circumstances.

Belgian residents which fall within one of the following categories should inform the National Bank of Belgium (Banque Nationale de Belgique/Nationale Bank van Belgie) (NBB) of their professional foreign transactions:

- the 1,050 biggest companies;
- coordination centers; or
- the financial sector.

In addition, Belgian residents outside those categories should provide the NBB (if requested to do so) with information with respect to their transactions with countries abroad.

There are also anti money laundering, cash control and tax considerations to take into account.

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**What are the rules around financial promotions?**

Financial promotions are not generally defined in Belgian law.

A financial promotion refers to a communication of an invitation or inducement to engage in investment activity made by a person in the course of business. Since such communications can influence consumers, a person is restricted from communicating such promotions unless they are an authorized person, or the content of the communication has been approved by a competent authority, or the promotion falls within one of the exemptions.

**Rules**

Different laws and regulations regulate financial promotions, such as the Belgian Code of Economic Law, the Law of 2 August 2002, the Prospectus Law, the UCITS Law, the AIF Law, the Royal Decree of 25 April 2014 on certain information requirements in relation to marketing of financial products with non-professional clients and circular letters from the Financial Services and Markets Authority (Autorité des services et marchés financier/Autoriteit voor Financiële Diensten en Markten) in this respect.

Below an overview of the rules governing the distribution of financial instruments in force in Belgium:

- Belgian prospectus law

Under the Belgian prospectus law, marketing is defined very broadly as the presentation of a financial product, in any manner, to encourage the client or potential client to buy or subscribe the relevant financial product (article 11).

Pursuant to article 60 of the Belgian prospectus law, ex ante/a priori supervision by the FSMA of advertising is required for investments instruments offered to the public that are subject to the requirement of a prospectus.

The advertising or marketing materials shall observe the following principles:

- they shall state that a prospectus has been or will be published and indicate where investors are or will be able to obtain it;
- they shall be clearly recognizable as such.
• the information contained in advertising or marketing materials shall not be inaccurate, or misleading. This information shall also be consistent with the information contained in the prospectus;

• Marketing Royal Decree

The Royal Decree of 25 April 2014 regarding certain information obligations for the marketing of financial products to retail clients (the "Marketing Royal Decree") also provides rules on marketing documents for financial products marketed to retail clients in Belgium.

The rules apply to the retail marketing of any financial product in Belgium. Accordingly, foreign entities conducting activities in Belgium on a cross-border basis (or through a branch) also fall under the rules. It should be noted that they only apply to marketing addressed to MiFID retail clients.

Marketing is again defined very broadly as the presentation of a financial product, in any manner, to encourage the client or potential client to buy, subscribe, adhere, accept, sign or open the relevant financial product. This covers both public offers and private placements. The new regime creates an obligation regarding the content and presentation of marketing documents.

The Marketing Royal Decree sets forth a series of rules on the content and presentation of marketing materials including general principles such as fair and not misleading content, minimum criteria with regard to the content of marketing materials, the presentation of future and past performance information, disclosures on award and rating and comparisons between financial products.

All marketing materials must be approved beforehand by the FSMA.

• Book VI of the Code of Economic Law

Book VI of the Code of Economic Law on "Market practices and consumer protection" sets forth general rules applicable to advertising. Book VI regulates abusive advertising, misleading advertising and comparative advertising.

• Ban on the marketing of certain financial products

In Belgium, the marketing of certain financial products to retail clients in Belgium is banned by a Royal Decree of 24 April 2014 that applies to financial products that are based on so-called non-mainstream or non-standard assets.

The Regulation bans the marketing of several classes of products:

• financial products that depend on a life settlement, in other words, traded life assurance policies;

• products that consist essentially of derivatives based on virtual currencies such as Bitcoin.

• notes and class 23 insurance contracts where the return depends on an alternative investment fund that invests in non-standard assets and to class 23 insurance contracts whose return depends on an internal fund invested in such non-standard assets (such as commodities, artworks, and consumer products like wine or whisky).

Depending on the financial product concerned, non-authorized financial promotions can be sanctioned by criminal, administrative and civil penalties.

Exemptions

Exemptions include certain promotions when certain safe harbor conditions are met, such as the offer of investment instruments to qualified investors.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally
The most common types of legal entities are limited companies, which are body corporates with separate legal personality and limit the liability of their members.

Limited companies can either be private (private limited liability company, société à responsabilité limitée/besloten vennootschap) or public (public limited company, société anonyme/naamloze vennootschap), depending on whether their shares are offered to the public.

Usually, regulated entities are incorporated as public limited companies which is the legal entity favored by large enterprises.

Funds

Investment funds mostly take the form of public limited companies, partnerships limited by shares or contractual schemes.

Fund managers should be public limited companies.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

To the extent that it concerns activities subject to mutual recognition, European Economic Area (EEA) credit institutions and other financial institutions authorized to offer such activities in their home member state, can start these activities in Belgium, either under the freedom to provide services or via the establishment of a branch.

Non EEA entities need to be authorized to conduct regulated lending or investment business through a branch or establishment.

Foreign companies carrying on a trade in Belgium through a 'permanent establishment' or 'Belgian establishment' will be subject to Belgian corporation tax.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

Peer-to-peer lending as such is forbidden by law in Belgium. On one hand, the Prospectus Law prevent individuals to raise funds publicly, even through an intermediary platform. This means that a borrower candidate cannot invite other people publicly to lend him money. On the other hand, one needs to be a regulated lender to grant loans and to get access to the Central Individual Credit Register.

Crowdfunding is regulated by the Law of 18 December 2016, which introduced a bespoke crowdfunding regime for platforms in Belgium. This regime applies only to crowdfunding entailing a financial return for investors. This specific form of crowdfunding can itself be broken down into two types: debt-based and equity-based crowdfunding.

Blockchain, smart contracts and cryptocurrencies

What is Blockchain?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm
functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. The process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as Bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more complex interactions with the outside world using so called ‘Oracles’. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?
ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as 'robo advisors,' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**
Regulation of payments services

Businesses that aim to provide payment services require prior authorization from the NBB under the Law of Law of 11 March 2018 transposing the Second European Union Payment Services Directive (PSD II). In order to become authorized, payment service providers need to meet certain criteria, including in relation to the business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

Application of data protection and consumer laws

The European General Data Protection Regulation (GDPR) entered into force with direct effect on 25 May 2018. The GDPR offers citizens a wider control around the use of their personal data.

Money laundering regulations

The Law of 18 September 2017 on the prevention of money laundering and terrorist financing and on the restriction of the use of cash implements the Fourth Anti Money Laundering Directive (4AMLD). Suspicious transactions have to be reported to the Belgian Financial Intelligence Processing Unit. As mentioned above, the Belgian Minister of Justice intends to bring virtual currency exchanges into the scope of the Belgian Anti-Money Laundering Act in the future.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals, (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform (the so-called 'alternative financing platforms'). The FSMA website currently shows 6 registered alternative financing platforms.

There are three main types of crowdfunding: equity-based, debt-based and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Debt-based crowdfunding (also known as crowdlending): funders lend money to a company and look for interest payments as well as the full repayment of the principal.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

There are various incubators or accelerators in the Belgian market, which offer support and facilities for startups. Several competitions are being organized by financial market players in order to attract ideas, which may in turn be rewarded with initial financing.

Banks are equally keen to keep an eye on promising projects in the Belgian market. ING Belgium in 2017 offered a full FinTech incubator experience to startups in search of professional guidance and early stage advisory. The ING FinTech Village was a four-month scheme to
which startups or scale-ups could apply in order to develop FinTech applications, while being provided with appropriate accommodation, support and advice offered by board level professionals from across the financial sector.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund, a Belgian example of which is the FinTech platform B-Hive. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor. In Belgium, FPIM (Federal Holding and Investment Company), a government investment body, made considerable contributions to B-Hive's fundraising, thus stressing the state's intentions to stimulate the sector's early development. More government capital funding initiatives are expected to be launched in the near future.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), secured against a company's assets and including an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

**Warehouse and platform funding**

Warehouse financing may be suitable for (typically larger scale) FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Another internationally available alternative form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead, interest is paid on the money borrowed. However, as mentioned above, this type of lending is currently not available in the Belgian market, given the hostile regulatory environment.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis, depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

Belgium has both debt and equity capital markets which are accessible to businesses (usually of a certain size). The Belgian capital market, however, is not readily available to companies in startup or scale-up stages. In recent years, IPOs and especially securitizations have been scarce. There is a tendency for successful Belgian startups to move abroad in their early stages.

**CONVERTIBLE BONDS/LOAN NOTES**

Another funding tool for fast-growing FinTech businesses, is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

**Incentives and reliefs**

Under Belgian law, a tax shelter is available for investors in startup companies including FinTech initiatives. Depending on the size of the company receiving funding, the Belgian taxpayer-investor is entitled to a 30% or 45% tax reduction. Companies are therefore being divided into micro-enterprises and SMEs, with the number of employees being one of the decisive factors (less than 10 for the former and less than 50 for the latter).
Private equity funds are more open to companies envisaging a steep growth trajectory. Both private and public debt is available in every region of Belgium. Often government subsidies can be obtained for innovative initiatives with a solid business prospect.

In early 2017 a new FinTech focused investment fund was set up to provide funding to FinTech initiatives in the Belgian market. Such funds often benefit from government contributions. More similar initiatives have been announced for the near future.

**Portfolio sales**

**Loan transfers and portfolio sales**

*What are common ways of buying and selling loans?*

Buying and selling loans is not very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

- **Cession** – A cession is a full legal transfer of the party's rights. It is an arrangement whereby the existing lender transfers his rights to a transferee. The latter thus takes over the rights under the existing contract which is to be continued.

- **Sub-participation** – The original lender will remain the only creditor of the borrower, and the only beneficiary of the security package. Based on the sub-participation agreement, the sub-participant has a contractual right to amounts received by the principal lender, but no direct in rem right against the borrower, nor over the security assets.

- **Belgian law LMA standard documentation** – In case of large syndicated loans, it is market practice to use the LMA standard contracts, with the necessary amendments so that it can be governed by Belgian law. For the transfer of rights created thereby the transfer mechanisms provided in this documentation can be used.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

*What are the main considerations when transferring a loan and related security?*

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Key considerations include the following.

**Notification**

A transfer via cession is valid and enforceable against third parties following the agreement between the lender and the transferee. However, the borrower needs to be notified or has to acknowledge the cession.

**Transfer security interest - novation**

In case of a transfer by way of novation, all security rights relating to the initial debt are extinguished, unless explicitly preserved. A clause containing this preservation can be included in the original facility agreement.
Transfer security interest – cession

In principle, all security rights that have been put in place in connection with the transferred debt are automatically transferred. However, for each transfer of (part of) a loan secured by a mortgage, a marginal note (kantmelding/inscription marginale) in the Mortgage Registry must be made, which will involve the payment of a 1% registration tax (calculated against the secured amount) unless the transfer is made between certain categories of lenders (such as an EEA-licensed credit institution or mobilisation institutions).

Confidentiality

Consider whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser.

Data protection

Consider whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser.

Lender eligibility

Consider whether there are any restrictions around the type of entity to which the loan can be transferred.

Undrawn commitments

Consider whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee.

Transfer mechanics

Consider whether there are any steps that need to be taken to transfer the loan in accordance with its terms.

Consent

Consider whether a transfer requires the consent or notification of any other parties.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in Belgium varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

The gas and electricity industries in Belgium are privatized, with generation, transmission, distribution and supply services provided by a number of private sector companies. The relevant private sector companies own the generation, transmission and distribution assets. Notably two listed public companies (albeit heavily regulated) play major roles:

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Elia, the transmission network manager, owns all of the electricity transmission lines. Fluxys, the transport network manager, owns all of the gas transmission lines. Transmission and transport networks are thus owned by these two companies.

For the distribution of energy however, Belgium relies on distribution network managers, each of whom owns its respective distribution network. Most of these distribution network managers leave the exploitation of their networks to be handled by one of the three recognized working companies (Fluvius and ORES).

The private sector finances and delivers most of the required infrastructure but there are a number of government policy mechanisms (adopted through legislation) which are used to incentivize investment in eligible energy generation technologies. In certain instances, including on major energy infrastructure, projects may be procured by the public sector and depending on the terms of the procurement, the asset may either be publicly or privately owned.

The pricing and tariffs of transmission and transport network managers are monitored by the the Commission de Régulation de l’Électricité et du Gaz/Commissie voor de Regulering van de Elektriciteit en het Gas (CREG). This federal agency equally controls the technical functioning of these networks.

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in Belgium are privately owned by three service providers: BASE, Orange and Proximus. However, Proximus (responsible for most of Belgium’s broadband infrastructure) may be distinguished from BASE and Orange, because (unlike BASE and Orange) its majority shareholder is the Belgian government.

The Institut belge des services postaux et des télécommunications (IBPT)/Belgisch Instituut voor Postdiensten en Telecommunicatie (BIPT) is the regulator of Belgium’s telecommunications sector. It also has responsibility for radio and television broadcast services and postal or wireless communications services.

Transport infrastructure

HEAVY RAIL

The rail market in Belgium is semi privatized but its composition (which is complex) involves both ‘autonomous public’ and private entities. The principal elements to the rail sector in Belgium are as follows.

The main player in Belgian railway infrastructure is the Société nationale des chemins de fer (SNCB)/Nationale Maatschappij van Belgische Spoorwegen (NMBS). This is a 100% state owned company which is set up to operate independently from governmental instructions, as an ‘autonomous governmental company’. Therefore, it is led by an autonomous board, to resemble a private sector participant.

Infrabel, another autonomous governmental company, manages the Belgian railway infrastructure. The SNCB/NMBS is Infrabel’s most important customer. It is equally responsible for the maintenance, renovation or renewal and development of the Belgian railway network.

All railway operators in Belgium need an Infrabel license to use their infrastructure. At the end of 2019 Infrabel has granted access to 15 railway companies involved in transport of passengers or goods.

LIGHT RAIL

Tram networks in Belgium are owned by regionally owned public transportation companies:

- De Lijn (in Flanders);
- MIVB (in Brussels); and
- TEC (in Wallonia).

Since their revenues are consistently too low to cover their operating costs, the respective regional governments annually provide subsidies in respect of these deficits.

PROJECT FINANCE
In most construction deals the project will be procured through a project finance model.

An example of a recent railway PPP is the Antigoon tunnel, the construction of which was completed in 2014. This has been built through a Design Build Finance Maintain (DBFM) construction by a private consortium receiving public financing from Infrabel and the Flemish government. The remainder of funds were provided by the European Investment Bank and a small syndicate of credit institutions. After the 38 year maintenance period the ownership will be transferred to Infrabel.

Since 2010 it has become common practice for tramway or bus construction projects as well to be conducted as PPPs.

The rail sector is regulated by the Regulatory Body for Railway Transport and for Brussels Airport Operations. Its objectives and responsibilities are to supervise the market, to guard the interests of the users and the general public and to advise participants on certain sector related topics.

ROADS, BRIDGES AND TUNNELS

In Belgium the regional authorities (through their main agencies AWV and DG1) are responsible for constructing and maintaining roads, bridges and tunnels.

Regional government entities are in charge of operating, maintaining and improving the major highways and all secondary roads in Belgium. Some local roads are the responsibility of local authorities or municipalities. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. Belgium has no privately owned or exploited toll roads.

AVIATION

Aviation in Belgium is mostly privatized, although government financing remains substantial. As regards airport infrastructure, there are a number of ownership structures in the Belgian market, including private ownership, local government ownership and public private ownership. Belgium’s main airports are Ostend, Antwerp, Brussels (Zaventem), Charleroi and Liège.

PORTS

The Belgian ports sector comprises a number of companies and regional ports, all operating on commercial principles, all to a certain extent benefiting from public subsidy.

Belgium's largest port is the Port of Antwerp, which is operated by the Antwerps Havenbedrijf, a public state owned company. Other large and heavily industrialized ports include Zeebrugge, Ostend, Ghent, Brussels and Liège.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector, with private sector operators responsible for aspects such as the design, build, financing, operation and maintenance of the infrastructure. The majority of social infrastructure assets in Belgium are directly financed by the government. Subject to value for money considerations, private finance may also be used in the procurement of social infrastructure assets. In relation to some of these specific sectors:

Education

The ownership of a school's infrastructure depends upon which category of school it belongs to. For example, in the case of a local authority maintained school, the school and playing fields will be owned by the local authority. The program for new schools currently being implemented is called Scholen voor Morgen. This is a large scale DBFM based infrastructure program of the Flemish government in order to improve educational infrastructure region wide based on private sector financing.

Hospitals

Ownership of hospitals is vested in various public sector bodies. The Belgian regions have competency in respect of the provision of healthcare services in their respective jurisdictions, so the majority of hospitals in Belgium operate under their supervision. However, most hospital funding is provided at a federal level, with additional regional government subsidies, often complemented by private financial sector loans. In general, hospitals equally contribute to the repayment of such loans through their own funds.
Social housing

This is a diverse sector involving many different organizations and individuals including housing developers, building contractors, mortgage lenders, local authorities, housing associations, landlords, owner occupiers, private renters and those in the social rented sector. Typically, on a social housing project, government led social care institutions own and exploit the relevant housing stock. Where similar projects are run by private sector participants, their activities tend to be constrained by public sector regulation.

Defense

Typically, defense assets are owned by the public sector.

Waste

Waste collection is typically coordinated and provided at a public sector level, whereas waste processing is handled primarily by private sector players. Waste processing facilities developed and operated by private sector entities typically serve both public sector and private sector customers and various waste processing initiatives such as car wreck, waste oil and waste medication reclamation can be subsidized with either federal or regional government budgets, depending on the intergovernmental competences.

Water

In Belgium drinking water, industrial water and wastewater services are provided by state-owned companies. These are regionally organized but can also have a subdivision at local levels. All are typically funded through public means.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in Belgium over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (e.g., merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body (e.g., a government department, a local authority or an autonomous government company) is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval. Key sector specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on “Change of Control.” This is less of a concern on private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy markets in Belgium have a complex system of arrangements between suppliers, generators, transmission and distribution network managers which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanisms with suppliers, customer and the layered energy operator system. These are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Both market participants and investors regularly point out the lack of stable regulatory framework which hampers large-scale investments in the Belgian energy market. In particular, uncertainty surrounding the longevity of nuclear plants and fiscal regulations continues. Mild political instability has proven to be an additional cost in this equation.

Telecoms infrastructure

Given the dispersed nature of this sector, various pieces of legislation need to be read jointly to get a sufficient understanding of the
applicable regulations. The interplay of competences is not to be underestimated, since the main legislation is to be found at both regional and national levels, in decrees and laws combined. Different permits/licenses may need to be obtained for the performance of various activities in the separate regions.

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

**Transport infrastructure**

**RAIL**

There is an extensive and complex regulatory framework to consider in respect of a practical and operational involvement in this sector. Key areas include understanding the regulatory regime for certification for train use and acceptance. As stated above, every service provider needs an Infrabel license in order to operate on the Belgian tracks.

The difficulty of investing in an existing rail project depends upon the nature of the investment and the specific type of entity or asset the investor wishes to invest in/acquire.

**ROADS**

A procuring public sector authority (a federal, regional or local authority) may delegate certain of its statutory duties in respect of certain types of road projects to private sector partners. In assuming these duties, private sector partners will, therefore, need to understand those duties and whether they are able to subcontract those duties to an appropriate person. There is usually a restriction on the change of control of the private sector partner during the construction period. Following the construction period, the private sector may be allowed a change of control provided that they do not fall within a definition of an 'Unsuitable Third Party' (which may include concerns about national security or tax avoidance). The precise scope of the restrictions will depend on the contractual terms.

**What is the applicable procurement process?**

Public procurement in Belgium is, for the time being, in most instances governed by the Law, which is based on EU Directives. There are some sector specific regulations such as the Royal Decree of 10 January 1996 on the public procurement of commissions of works, deliveries and services in the sectors of water, energy, transport and postal services.

The key principles are that contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

**Investing in energy and infrastructure**

Public procurement is relevant where one of the Belgian governments (whether national or regional), or a branch of them, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to certain public bodies including central government departments, local authorities, police and fire authorities, various non governmental bodies and autonomous governmental companies. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met, so a regulated procurement would need to take place.

In most cases, the public sector will need to publish a contract notice in the Official Journal of the European Union (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy to evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted. This is the most common procedure for relatively small-scale projects.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression-of-interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of
confirming the financial and other commitments in a tenderer’s bid.

- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement related considerations that need to be borne in mind.

### Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

*Last modified 18 Dec 2019*

## What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Belgium (including in relation to public private partnerships) are:

### Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project finance basis (to a special purpose project company) on medium to long term bases – such loans may later be syndicated to other funders.
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing.

Most commonly a small syndicate of national and/or international banks, and since recently, institutionalized investors (eg insurance companies), will be gathered to finance larger scale projects.

Funding is also, sometimes, provided by the European Investment Bank and export credit agencies.

### Investing

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of ‘equity’).

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### Restructuring
Enforcement and sanctions

When can there be regulatory investigations?

When the Financial Services and Markets Authority (Autorité des services et marchés financier/Autoriteit voor Financiële Diensten en Markten) (FSMA) or the National Bank of Belgium (Banque Nationale de Belgique/Nationale Bank van Belgie) (NBB) considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in administrative sanctions.

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What regulatory penalties may apply?

When a legal or regulation provision is breached, the Financial Services and Markets Authority (Autorité des services et marchés financier/Autoriteit voor Financiële Diensten en Markten) (FSMA) or the National Bank of Belgium (Banque Nationale de Belgique/Nationale Bank van Belgie) (NBB) may impose a financial penalty or withdraw the entity’s authorization. The regulator will publicize these penalties.

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What criminal penalties may apply?

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches under the Money Laundering Regulations; and
- engaging in regulated activities without proper authorization.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

ADVANCE OF A LOAN

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

The granting of a loan attracts a notional documentary tax of €0.15 per original document executed in Belgium if the loan is granted by a bank or by a (natural or legal) person who usually holds money on deposit.

TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN

No stamp, registration, transfer or other similar taxes are payable on the transfer or assignment of a debt under a loan. Additional taxes may, however, apply depending on whether security was taken or not.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?
TAKING OF A MORTGAGE, DEBENTURE OR OTHER SECURITY

Documents evidencing a mortgage over Belgian real estate attract (apart from notional documentary taxes) a 1% registration duty and a mortgage duty of approximately 0.3%.

Depending on the value of the secured debt, a retribution of €20 – €500 is due upon the registration or renewal of a pledge. Such retribution will also be due in case the pledge is modified (€12 - €300) or in case the pledge deregistered.

TRANSFER OR ASSIGNMENT OF MORTGAGE, DEBENTURE OR OTHER SECURITY

The transfer of a mortgage is subject to a 1% or 0.5% registration duty if the mortgage or the pledge concerns Belgian real estate. The transfer of a pledge is subject to a retribution of €10.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

ISSUE OF A DEBT SECURITY

No stamp, registration, transfer or other similar taxes are payable on the issue of a debt security.

TRANSFER OF DEBT SECURITY

The transfer or assignment of a debt security will give rise to a 0.12% tax if it is performed with the intervention of a professional intermediary established inside or outside of Belgium. This tax is capped at €1,300.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over the tax authorities on enforcement of security.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Yes, Belgium levies withholding tax on interest payments under a loan.

If so:

What is the rate of withholding?

The current rate of Belgian withholding tax (ie the basic rate) is 30%.

What are the key exemptions?

Belgian domestic law provides for numerous withholding tax exemptions regarding interest payments. The following exemptions may be considered as key exemptions:

- the exemption for interest payments made between Belgian companies;
- the exemption for interest paid by Belgian resident professional investors to credit institutions established in the European Economic Area or in a country with which Belgium has concluded a double tax treaty; and
- reliance on the EU Interest and Royalties Directive as implemented by Belgian law.
A withholding tax exemption may also be obtained, in whole or in part, by virtue of double tax treaties concluded by Belgium.

**Would the same analysis apply to interest payments under a debt security (e.g., a bond)?**

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

There are also withholding tax exemptions that specifically apply to interest payments under a debt security. For example, there is an exemption for interest paid by the issuer of Belgian registered bonds to 'non-resident savers' and interest paid on registered non-capitalization bonds and on securities cleared through the X/N clearing system (managed by the National Bank of Belgium).

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g., by virtue of incorporation, residence or local branch)?

No.

**Would the same analysis apply to interest payments under a debt security (e.g., a bond)?**

Yes.

**Key contacts**

**Johan Mouraux**
Partner
DLA Piper UK LLP
johan.mouraux@dlapiper.com
T: +32 02 500 1673
Brazil

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under Brazilian law, in general, and Brazilian Securities Commission (CVM) regulation, specifically.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Brazil or to request that they are admitted to trading on a regulated market operating in Brazil unless:

- an approved prospectus has been made available to the public; and
- the offer is registered with CVM.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Brazil are shares and debentures. Shares may be voting (ordinárias) or non-voting (preferenciais). Debentures may be unsecured, secured, benefiting from a floating charge or subordinated. They may also be convertible into shares.

Many different types of debt securities are offered in Brazil. Some common forms include:

- commercial papers and promissory notes, which are short term securities;
- credit bank notes (céduas de crédito bancário), which represent loans from banks and may be secured or unsecured;
- quotas of investment funds;
- derivative instruments such as securities linked to the value of one or more reference assets including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- warrants (bônus de subscrição), which are securities giving the holders the option to purchase the equity of the issuer or a related company.

There is also a number of types of securities in Brazil used to finance certain industries, in particular agribusiness and housing finance.
What are the differences between offering debt securities to institutional/professional or other investors?

Institutional/professional investors benefit from an exemption from registration of a public offer with the Brazilian Securities Commission (CVM). On January 16, 2009, CVM enacted Instruction No. 476 which establishes that a public offering of certain securities will no longer be subject to registration with CVM or have to comply with CVM provisions relating to public offerings of securities, as established by Instruction No. 400, dated as of December 29, 2003 if they comply with the following requirements:

- involve one of the securities mentioned in Instruction No. 476, including, but not limited to: commercial notes, banking credit certificates that are not the responsibility of a financial institution, debentures not convertible or not exchangeable into shares, real estate or agribusiness rights certificates issued by securitization companies registered with the CVM as publicly-held companies, quotas of close-ended investment funds and financial notes (letras financeiras);
- be only targeted to qualified investors (as defined in the applicable regulation of CVM);
- be intermediated by members of the securities distribution system;
- be marketed to a maximum of 75 qualified investors and subscribed or acquired by no more than 50 qualified investors; and
- not involve marketing efforts through stores, offices and establishments open to the public or public communication services.

Public offers to any other type/number of investors are not covered by that exemption and have to comply with the applicable requirements of CVM.

When is it necessary to prepare a prospectus?

Unless an exemption applies, a prospectus is necessary when there is a public offer of securities.

The sale, the sale commitment, the sale or subscription offer and the acceptance of a sale or subscription offer of securities shall be considered public distribution acts if involving any of the following elements:

- the use of sales or subscription lists or bulletins, leaflets, prospectus or advertisements addressed to the public by any means;
- the complete or partial search for undetermined subscribers or purchasers, even if attempted through standard communications directed to individually identified addressees, through employees, representatives, agents, or any individual or legal entity, whether they take part in the securities distribution system or not, or the consultation on the offer feasibility or the collection of an investment commitment with subscribers or undetermined purchasers if said consultation or collection is not in compliance with the applicable Brazilian Securities Commission (CVM) regulation;
- negotiations made in stores, offices or branches open to the public and addressed, in whole or in part, to undetermined subscribers or purchasers; or
- the use of oral or written marketing, letters, advertisements or notices, especially through mass or electronic media (pages or documents on the internet or other open computer networks and e-mail), which contain any communication addressed to the general public aiming at promoting, directly or through third parties acting on behalf of the offer or of the issuer, the subscription or disposal of securities.

For such purposes, a class, category, or group of people, even if individualized, with the exception of those who have had a close and regular previous commercial, credit, partnership or work relationship with the issuer, shall also be considered general public.

What are the main exchanges available?

The main exchanges are the São Paulo Futures and Stock Exchange (B3 - Brasil Bolsa Balcão S.A.).
Is there a private placement market?

Private placements are possible under Brazilian law, but, except for derivative transactions, there is no organized private placement market in the country.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers and, to a certain extent, brokers, are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Brazilian law. Brazil has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

There are a number of considerations that the investor has to bear in mind before investing debt securities. For instance, debt security terms and conditions typically contain provisions for meetings of investors to consider matters affecting the investors’ interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities and therefore subject to regulation by the Brazilian Securities Commission (CVM). According to Law No. 10,303 of 31 October 2001 the regulation and supervision of financial and investment funds (originally regulated and supervised by the Central Bank) were transferred to CVM.

What are common fund structures?

Under Brazilian law, funds are considered to be as an ownership right shared by more than one person or legal entity (referred to under Brazilian law as condominiums), with no legal personality. Usually, they are established either as open ended condominiums (in which an investor may require the amortization of its quotas at any time, as provided for in the rules of the fund) or closed ended funds (in which the quotas are only amortized by the end of the life of the fund).

What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

The distribution of securities representing an interest in the capital of open-ended funds (referred to under Brazilian law as quotas) does
not require advance registration with the Brazilian Securities Commission (CVM). However, the public distribution of quotas of closed-ended funds do require advance registration with CVM and must comply with all of the formalities applicable to the public offer of securities in Brazil.

Institutional/professional funds

The offer of quotas of closed-ended funds directed only to professional investors are automatically granted by CVM, provided certain documents are delivered to CVM through its internal internet system. The distribution of quotas of closed-ended funds to professional investors with limited marketing efforts also benefit from the registration exemption set out in CVM Instruction No. 476, provided the following additional requirements are complied with:

- quotas are marketed to a maximum of 75 qualified investors and subscribed or acquired by no more than 50 qualified investors; and
- no marketing efforts through stores, offices, establishments open to the public or public communication services are used.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

In order for a fund to be established in Brazil it has to comply with the applicable rules of and be registered with the Brazilian Securities Commission (CVM). In accordance with the applicable regulation, the fund must have a manager and an independent accounting firm. The manager must be a Brazilian entity authorized by CVM for the performance of professional management of securities portfolios, in accordance with Article 23 of Law No. 6.385.

Investing in funds

Prospectuses for funds that are offered to the public in general must specify risk factors applicable to that type of investment.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

The distribution of quotas of funds (both open-ended or closed-ended) may only be done by entities authorized to operate in the securities distribution system in Brazil (eg brokers or investment banks).

The distribution of quotas of open-ended funds does not require advance registration with the Brazilian Securities Commission (CVM). However, the public distribution of quotas of closed-ended funds do require the previous registration with CVM and must comply with all the formalities applicable to public offer of securities in Brazil.

In any event, marketing materials of any type of funds in Brazil have to follow the applicable regulation of CVM, in particular Instruction No. 555.

Are there any restrictions on managing a fund?

The management of a fund is defined as the group of services directly or indirectly related to the functioning and maintenance of the fund. Those services may all be rendered directly by the manager of the fund or by third parties hired by the manager on behalf of the fund.

The manager is a legal entity duly authorized by the Brazilian Securities Commission (CVM) to provide securities portfolio management services, in accordance with Article 23 of Law No. 6.385 and other related regulations.
The manager may hire, on behalf of the fund, third parties duly authorized to render the following services to the fund (among others):

- portfolio managers;
- investment advisors;
- treasury services to manage the accounting for and control of financial assets;
- distribution of quotas;
- custody of financial assets;
- rating agencies; and
- market makers.

The management of the portfolio may be done by individuals or legal entities duly registered with CVM as professional portfolio managers.

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**Entering into derivatives contracts**

*Are there any restrictions on entering into derivatives contracts?*

Derivatives may be traded over-the-counter or on an organized exchange.

Multiple banks, commercial banks, investment banks, foreign exchange banks, broker dealers and securities dealerships are allowed to enter into swap, option, and future transactions in the Brazilian over-the-counter market on their own behalf and on behalf of their clients. Other financial institutions are only allowed to enter into this type of transaction on their own behalf. Those transactions have to be registered with an authorized clearing system in Brazil.

The Central Bank regulates the parameters for the calculation of the underlying indexes and prices for those transactions.

Brazilian companies may only enter into derivatives transactions in the international market for hedging purposes in connection with commercial or financial transactions which are subject to fluctuations in the international market of interest rates, foreign exchange or commodities prices. Those transactions have to be registered with a clearing system in Brazil.

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**What are common types of derivatives?**

Derivative contracts are entered into in Brazil for a range of reasons including hedging, trading and speculation.

All of the main types of derivative contract are widely used in Brazil:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying assets seen in Brazil are:

- equity;
- interest rates;
- commodities;
currencies; and

- credit.

Are there any other notable risks or issues around entering into derivatives contracts?

Netting arrangements have to be expressly agreed by the parties of any given transaction to be valid. This arrangement has to be documented in a specific agreement, either through a public or a private instrument. Alternatively, the financial institutions may have a global netting agreement with the client, covering all derivatives transactions entered into by then.

Those agreements have to be registered either with the Registry of Deeds and Documents or an authorized clearing system in Brazil within 15 days of their execution. The agreements must set out the conditions for an event of default to occur and the methodology for the calculation, set-off and liquidation of the transactions.

Although the new Brazilian Bankruptcy Law (Law No. 11.101 dated 9 February 2005) has brought additional protections for netting arrangements, there are still a number of risks involved in the exercise of netting in a bankruptcy situation.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Pursuant to the applicable regulation, financial institutions are prohibited to carry out credit operations with related parties, except in some limited circumstances. For this purpose, the law defines as a financial institution's related party the following:

- its controlling shareholders, directors and members of other statutory bodies (fiscal, advisory and others) and their respective spouses and relatives up to second degree;

- individuals or legal entities that hold a qualified interest (as per current regulations) in their capital;

- legal entities in which they have qualified interest (direct or indirect);

- legal entities in which they have effective operational control or preponderance in the deliberations, regardless of the equity interest; and

- legal entities with common directors or members of the board of directors.

The restrictions with respect to transactions with related parties do not apply to: (i) transactions carried out under conditions compatible with the common market (including, but not limited to, in respect of limits, interest rates, grace periods, guarantee requirements and risk classification criteria), which shall be similar to those conditions that the financial institution adopts in transactions with unrelated parties; (ii) arms-length transactions with entities controlled by the Union, (iii) credit operations whose counterparty is a financial institution that is part of the same prudential conglomerate, provided that they contain a subordination clause; (iv) certain interbank deposits; (v) setoff obligations; and (vi) other situations authorized by the CVM.

Moreover, there are currently certain restrictions imposed on financial institutions limiting the extension of credit to public sector entities, such as government subsidiaries and governmental agencies. These are in addition to certain limits on indebtedness to which these public-sector entities are already subject.

Borrowing

Borrowers are generally not regulated. Borrowers under consumer and housing financing usually benefit from the protection of the
What are common lending structures?

Lending in Brazil can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can vary between:

- a term loan, provided for an agreed final period of time;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional/professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

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**Do the laws recognize the principles of agency and trusts?**

Brazilian law does not recognize the concept of a trust. Although not specifically regulated, agency is not a prohibited activity in Brazil and may be structured through other Brazilian law instruments, such as the combination of a power-of-attorney and a service agreement.

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**Are there any other notable risks or issues around lending?**

**Generally**

Loan agreements and other finance documents are subject to general contractual law regulation (set out in the Brazilian Civil Code). For example, Article 192 of the Brazilian Constitution, enacted in 1988, established a 12% per year ceiling on bank loan interest rates. However, since the enactment of the Constitution, this rate had not been enforced, as the regulation regarding the ceiling was pending. Several attempts have been made to regulate the limitation on bank loan interest, but none of the proposals has been implemented. On 29 May 2003, Constitutional Amendment No. 40 (EC 40/03) was enacted and revoked all subsections and paragraphs of Article 192 of the Brazilian constitution. This amendment allowed the Brazilian financial system to be regulated by specific laws for each sector of the system rather than by a single law relating to the system as a whole. With the enactment of the new Brazilian Civil Code (or Law No. 10,406 of 10 January 2002), unless the parties to a loan have agreed to use a different rate, in principle the interest rate ceiling has been pegged to the base rate charged by the National Treasury Office (Tesouro Nacional). However, there is presently some uncertainty as to whether the target rate set by Special Clearance and Escrow System (Sistema Especial de Liquidação e Custodia, or SELIC) or the 12% per annum interest rate established in the Brazilian tax code should apply.

The impact of EC 40/03 and the provisions of the new Civil Code are uncertain at this time but any substantial increase or decrease in the interest rate ceiling could have a material effect on the financial condition, results of operations or prospects of Brazilian financial institutions.

Consumer loans are also generally subject to the restrictions of the Consumer Defense Code and certain other related regulation from the Central Bank. In 1990, the Brazilian Consumer Defense Code was enacted to establish rigid rules to govern the relationship between product and service providers and consumers and to protect final consumers. In June 2006, the Brazilian Supreme Court of Justice ruled that the Brazilian Consumer Defense Code also applies to transactions between financial institutions and their clients. Financial institutions are also subject to specific regulation of the National Monetary Council (CMN), regulating the relationship between financial institutions and their clients. CMN Resolution No. 3,694 dated 26 March 2009, as amended, established new procedures with respect to the settlement of financial transactions and to services provided by financial institutions to clients and the public in general, aiming at improving the relationship between market participants by fostering additional transparency, discipline, competition and reliability on the part of financial institutions. The new regulation consolidates all the previous related rules. The main changes introduced by the Consumer Defense Code are described below:

- Financial institutions must ensure that clients are fully aware of all contractual clauses, including responsibilities and penalties applicable to both parties, in order to protect the counterparties against abusive practices. All queries, consultations or complaints regarding agreements or the publicity of clauses must be promptly answered, and fees, commissions or any other forms of service or operational remuneration cannot be increased unless reasonably justified (in any event these cannot be higher than the limits established by the Central Bank);

- Financial institutions are prohibited from transferring funds from their clients’ various accounts without prior authorization.

- Financial institutions cannot require that transactions linked to one another must be carried out by the same institution. If the transaction is dependent on another transaction, the client is free to enter into the latter with any financial institution it chooses.

- Financial institutions are prohibited from releasing misleading or abusive publicity or information about their contracts or services. Financial institutions are liable for any damage caused to their clients by their misrepresentations.

- Interest charges in connection with personal credit and consumer directed credit must be proportionally reduced in case of anticipated settlement of debts.

- Adequate treatment must be given to the elderly and physically disabled.

**Specific types of lending**
Payroll loans are a type of financial product under which the interest and repayment charges are deducted directly from employees' or retirees' pay checks. Since the repayment of payroll deduction loans is directly deducted from the salaries of public servants and private sector employees or from INSS (Brazilian Social Security System) retiree or pension benefits, in practice the credit risk is that of the entity to which borrowers are related. This feature enables banks to extend loans at rates lower than those charged in connection with other products offered by financial institutions in Brazil. This payment deduction mechanism is regulated by a number of laws and regulations, at the federal, state and municipal levels, which establish deduction limits and provide for the irrevocability of the authorization given by a public servant, private sector employee or INSS beneficiary to deduct the amount for purposes of settlement of the loan.

In addition, the extension of payroll deduction loans to public servants and social security service (INSS) retirees and pensioners depends on the authorization by public entities to which these persons are related.

If an employee's employment contract terminates, whether through termination by the employer, voluntary departure or death, repayments under the loan will depend mainly on the financial ability of the borrower or his/her successors to repay the loan. In certain instances, the borrower can offer their severance package as collateral. However, such security may not be able to cover the amount borrowed since there are some limitations on the amount to be offered as collateral. Similarly, if a private employer suffers losses or enters financial distress or bankruptcy, it may not be able to pay the salaries on which the payroll deductions depend. Any of these events could increase the risk in payroll loan portfolios and increase the need for measures to control default through restrictions on new loans, which may adversely affect a company's financial condition and results. Finally, under Brazilian law, if a borrower whose payments are deducted from his salary gets divorced or separated from his spouse, alimony payments may be directly deducted from his salary. These deductions may have priority over other liabilities (including over amounts owed to banks), thus potentially limiting a bank's ability to receive repayment.

**Standard form documentation**

The Brazilian market does not have standard form documentation for loans.

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**Are there any other notable risks or issues around borrowing?**

Borrowers should be aware of the potential implications of the laws dealing with failing financial institutions.

In case of bankruptcy or liquidation of a financial institution, certain credits, such as credits for salaries up to 150 minimum wages (salários mínimos) per labor creditor (ie a creditor deriving from labor relationships with the employees), among others, will have preference over any other credits.

The Brazilian market has a deposit insurance system (FGC) which guarantees a maximum amount of R$250,000 of deposits and credit instruments held by an individual against a financial institution (or against financial institutions of the same financial group) and a maximum amount of R$20 million of deposits for banks with deposits, up to R$5 billion per bank. The FGC is funded principally by mandatory contributions from all Brazilian financial institutions that work with client deposits. The payment of unsecured credit and client deposits not payable under the FGC is subject to the prior payment of all secured credits and other credits to which specific laws may grant special privileges.

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**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**

Some of the key areas affecting the giving of guarantees and security are as follows.

**General comments**

The creation of a security interest (in rem guarantee) is a very formal procedure under Brazilian law. In order for it to be valid and enforceable in Brazil, the underlying obligation being guaranteed and, if such obligation is related to, or part of, a more complex transaction, the transaction as a whole must be considered legal, valid and binding under the relevant applicable laws. If the underlying
obligation, the transaction generally or just elements of the transaction are not valid, the guarantee or security is also invalid. Additionally, the security agreement must comply with certain conditions (which are considered below) and the parties to it must perform all required formal acts.

The conditions that a transaction (negócio jurídico – a term which includes security documents) must comply with are set out in Article 104 of the Brazilian Civil Code. The conditions concern the capacity of the parties, the existence of an object of the transaction and the form of the documents).

Capacity of the parties

Capacity relates to the power and authority of a given party to enter into a transaction. The parties to the security agreement must be properly represented and duly authorized and empowered to enter into the transaction and create a security interest over certain assets. Capacity is determined by reference to matters such as restrictions under the constitutional documents of the entity entering into the security agreement.

Object

Brazilian law prevents parties from entering into agreements in which the object is not possible or considered to be illicit under Brazilian law. An example of something that is not possible would be an agreement by two private parties to sell an asset owned by the state. An illicit object could be, for example, the exploitation of a casino in Brazil.

Form and other requirements

Security agreements must follow a form established or not forbidden under Brazilian law in order to be capable of being enforced in Brazil. For example, Article 1,452 of the Brazilian Civil Code and Article 127 of the Public Registries Law require that a pledge of shares be constituted by means of a written agreement (private or public) duly registered in the competent Registry of Documents and Deeds in Brazil.

Furthermore, the security agreement must be drafted in order to comply with the other formal requirements of Brazilian law, such as including a detailed description of the assets being pledged and the main financial terms and conditions of the obligation being secured, including:

- the principal amount of the debt;
- the repayment dates; and
- the applicable interest rate.

Economic benefit

In addition to the formalities for the creation of a security interest, the economic benefit generated or a commercial justification for the granting of such security interest by a given issuer of a security interest will have to be analysed. Although this aspect would not generally affect the validity or enforceability of the security agreement, if there is no economic benefit for the guarantor there is a risk of claims being filed by interested third parties, such as minority shareholders or other creditors of the guarantor upon the bankruptcy of the guarantor, as explained below.

Minority shareholders

As a general rule, minority shareholders of an issuer of a security interest may challenge the execution of a security agreement on the basis that the relevant transaction was not entered into in the best interests of the company. Any claim to be brought by minority shareholders on this basis would most likely relate to the fact that there was an abuse of power by the controlling shareholder and/or that the managers carried out acts that conflicted with the company’s best interests. The grounds supporting any such claim for damages placed by minority shareholders may be strengthened to the extent that the security interest is enforced.

Creditors’ claims

Creditors of an issuer of a security interest may also challenge the execution of a security agreement if the transaction is not justifiable from an economic or commercial point of view. A Brazilian court will take into account the current credit strength (ie solvency) and the
What are common types of guarantees and security?

Common forms of guarantees

Generally, there are two types of personal guarantees: surety (fiança) and the so-called ‘aval’. Under a surety, an individual or a legal entity undertakes to perform/repay an obligation if the obligor fails to do so. Aval is a specific guarantee used to secure debt instruments. Personal guarantees are always formalized in writing.

Common forms of security

There is more than one type of in rem guarantee. The nature of the assets that support the guarantee affect which type of in rem guarantee is used. Under Brazilian law, assets can be divided into the following categories:

- movable assets, eg shares and equipment; and
- immovable assets, eg land and buildings.

Certain assets such as aircraft and ships, although considered to be movable assets, are subject to the requirements applicable to immovable assets (such as registration requirements).

The two most usual types of in rem guarantees are:

- pledge (penhor), which relates to movable assets and credit rights; and
- mortgage (hipoteca), which relates to immovable assets.

In the case of in rem guarantees, each asset given as security must be duly referred to in the relevant agreement.

The Brazilian Civil Code provides for another form of guarantee in respect of movable assets which are not fungible. This type of guarantee results in the ownership of the asset and the indirect possession of it being transferred to the creditor, while direct possession remains with the guarantor. The guarantor assumes the duties and liabilities of a bailee in relation to that asset.

Are there any other notable risks or issues around giving and taking guarantees and security?

Upstream and cross-stream guarantees

Upstream and cross-stream guarantees are not prohibited by Brazilian law. Where a guarantee is given in respect of the obligations of a non-Brazilian holding company, certain foreign exchange restrictions may apply.

Financial assistance

Financial assistance (which under Brazilian law includes assistance by way of loans, guarantees, security or reduction of liability) is not specifically regulated by Brazilian law. However, depending on the legal status of the company (regulated entity, financial institution, publicly or privately held corporation, limited liability etc), and the relationship between the grantor and the beneficiary of the financial assistance, restrictions may apply.

For example, financial institutions are prohibited to carry out credit operations with related parties (as defined in specific regulation), except in some limited circumstances.

Additionally, if financial assistance involves a company located outside Brazil, certain foreign exchange rules will have to be observed.

It will be necessary to take advice on a case-by-case basis as to whether restrictions apply to a particular scenario.
Notarization and apostillation or consularization

If security agreements are signed by a party outside Brazil, it must be duly apostilled (apostilado) by the competent authority of the place the foreign judgement was issued or, in case the country in which the place the foreign judgement was issued is not a party to the 1961 Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents of 5 October 1961, be legalized by a consular official of Brazil having jurisdiction over the place of issuance.

Translation into Portuguese

Only Portuguese language documents may be registered with Brazilian public registries. If the security agreements are not drafted in Portuguese, they must be translated into Portuguese by a certified translator and registered with the competent Brazilian Registry of Deeds and Documents or Real Estate Registry, as the case may be.

Registration

In order to be valid against third parties (and to ensure priority in a bankruptcy proceeding), the security agreements must be registered with the appropriate Brazilian public registries. The relevant register depends on the nature of the asset secured. For example, security over moveable assets other than planes, trains and ships is registrable at the appropriate Registry of Deeds and Documents in Brazil. Security over real estate should be registered at the appropriate Real Estate Registry. Other registrations may be required according to the type of asset that is secured. For example, security over shares in a Brazilian company would need to be registered in that company's share registry book.

Fees

The registries in Brazil will charge a fee to perform the registration of the security agreements or any amendments to them. The amount to be charged by the registries will depend on the:

- location in which the security agreement must be registered in (for instance, mortgages must be registered in the place where the real estate asset is located); and
- amount being secured.

There will also be the cost related to the translation of the security agreements into Portuguese, which will be charged by the certified translator based on the number of pages to be translated, as well as the cost related to the apostillation or consularization of the signatures.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Law No. 4.595 (Brazilian Financial System Law) 31/12/1964
Law No. 10.406/2002 (Brazilian Civil Code - Código Civil) 10/01/2002

Consumer credit

Law No. 4.595 (Brazilian Financial System Law) 31/12/1964
Law No. 8.078 (Brazilian Consumer Defense Code – Código de Defesa do Consumidor) 11/09/1990
Mortgages

Law No. 9.514 (Brazilian Real Estate Financial System) 20/11/1997  
Law No. 10.406/2002 (Brazilian Civil Code - Código Civil) 10/01/2002

Corporations

Law No. 6.404 (Brazilian Corporation Law – Lei de Sociedades por Ações) 15/12/1976

Funds and platforms

Brazilian Securities Commission (CVM - Comissão de Valores Mobiliários) Instruction No. 555 17/12/2014

Other key market legislation

Law No. 4.728 (Brazilian Stock Markets Law) 14/07/1965  
Law No. 6.385 (Brazilian Securities Law) 07/12/1976

Last modified 4 Dec 2019 | Authored by Campos Mello Advogados

Regulatory authorization

Who are the regulators?

The basic structure of the Brazilian financial system (Sistema Financeiro Nacional) was established by Law No. 4.595, which created the CMN (as defined below) and granted the Central Bank, among other things, the powers to issue money and control credit.

Main regulatory agencies

The Brazilian financial system consists of the following regulatory and fiscal bodies:

- the National Monetary Council (Conselho Monetário Nacional or CMN);
- the Central Bank of Brazil;
- the Brazilian Securities Commission (Comissão de Valores Mobiliários or CVM);
- the Superintendence of Private Insurance (Superintendência de Seguros Privados or SUSEP); and
- the Complementary Pensions Secretariat (Superintendência Nacional de Previdência Complementar - PREVIC).

The CMN and the Central Bank regulate the Brazilian banking sector. The CVM is responsible for the policies of the Brazilian securities market. Below is a summary of the main attributes and powers of each of these regulatory bodies.

The CMN

Currently, the CMN is the highest authority in the system and is responsible for Brazilian monetary and financial policy and for the overall formulation and supervision of monetary, credit, budgetary, fiscal and public debt policies. The CMN is responsible for:

- adjusting the volume of forms of payment to the needs of the Brazilian economy;
- regulating the domestic value of the currency;
- regulating the value of the currency abroad and the country's balance of payments;
- regulating the constitution and operation of financial institutions;
- directing the investment of the funds of financial institutions, public or private, taking into account different regions of the country and favorable conditions for the stable development of the national economy;
supervising Brazil's reserves of gold and foreign exchange;

- enabling the improvement of the resources of financial institutions and instruments;
- monitoring the liquidity and solvency of financial institutions;
- coordinating monetary, credit, budgetary, fiscal and public debt policies; and
- establishing the policy used in the organization and operation of the Brazilian securities market.

The Central Bank

Law No. 4.595 granted the Central Bank powers to implement the monetary and credit policies established by the CMN, as well as to supervise public and private sector financial institutions and to apply the penalties provided for in law, when necessary. According to Law No. 4.595, the Central Bank is also responsible for, among other activities, controlling credit and foreign capital, receiving mandatory payments and voluntary demand deposits from financial institutions, carrying out rediscount operations and providing loans to banking institutions, in addition to functioning as the depository for official gold and foreign currency reserves. The Central Bank is also responsible for controlling and approving the operations, the transfer of ownership and the corporate reorganization of financial institutions, as well as the establishment of transfers of principal places of business or branches (whether in Brazil or abroad) and requiring the submission of periodical and annual financial statements by financial institutions.

The President of the Central Bank is appointed by the President of Brazil, subject to ratification by the Federal Senate, and holds office for an indefinite period of time.

The CVM

The CVM is a government agency of the Ministry of Economy, with its headquarters in Rio de Janeiro and with jurisdiction over the whole Brazilian territory. The agency is responsible for implementing the securities policies of the CMN and is able to regulate, develop, control and supervise this market strictly in accordance with the Brazilian Corporate Law and securities laws.

The CVM is responsible for regulating the supervision and inspection of publicly-held companies (including with respect to disclosure criteria and penalties applicable to violations in the securities market), the trading and transactions in the securities and derivatives markets, the organization, functioning and operations of the stock exchanges and the commodities and futures exchanges and the custody of securities.

What are the authorization requirements and process?

The Central Bank's approval process

The incorporation of a financial institution in Brazil requires the prior approval of the Central Bank.

On 2 August 2012, the National Monetary Council (CMN) enacted Resolution No. 4.122, which regulates, amongst other things, the requirements and procedures for the authorization for organization and operation of financial institutions and other types of financial institutions.

In general terms, the incorporation process must begin with a written request to be filed with the Central Bank containing a number of required documents. After the documentation mentioned is received by the Central Bank, it will summon the future controlling persons of the financial institution for a technical interview so that they can present their proposal. According to Resolution 4.122, the Central Bank may, at its sole discretion and on a case-by-case basis, waive the need for a technical interview, if it believes that the venture proposal is sufficiently explained in the executive summary and that the future controlling persons have demonstrated sufficient knowledge on the business field and in the sector that the financial institution intends to operate.

If the Central Bank does approve the transaction, the applicant will have to comply with several requirements imposed by Resolution No. 4.122 within a certain period of time. Once the Bank of Brazil considers that all the requirements have been properly met, it will be in position to grant the necessary approval for the financial institution to operate in Brazil. The entire process may take from eight months to one year (or more) to be completed.
The regulator will also approve key individuals (e.g., senior management) in their roles.

**Foreign banks**

The Brazilian Constitution prohibits foreign financial institutions from establishing new branches or subsidiaries in Brazil, except when duly authorized by the Brazilian government (by means of a presidential decree). A foreign financial institution duly authorized to operate in Brazil through a branch or a subsidiary is subject to the same rules, regulations, and requirements that are applicable to any Brazilian financial institution.

**Foreign investment in Brazilian financial institutions**

Notwithstanding the above, foreign investors may acquire publicly traded non-voting shares of Brazilian financial institutions negotiated on a stock exchange, or depositary receipts offered abroad representing non-voting shares without specific authorization. However, the acquisition by a foreign investor of voting shares of Brazilian financial institutions requires the authorization by the Brazilian government (by means of a presidential decree). In addition to that, the acquisition of a material interest or control of a financial institution (either by a foreign or local investor) requires the prior approval of the Central Bank.

Nevertheless, on September 26, 2019, the Presidency of the Republic issued Decree 10,029, empowering the Central Bank to authorize, among others, the increase of foreign equity interest into financial institutions authorized to operate in Brazil. In other words, a presidential decree authorizing investment in financial institutions is no longer necessary considering that the Central Bank has powers to recognize as of interest of the Brazilian government an increase in the percentage of equity in the capital of financial institutions headquartered in Brazil, held by individuals or legal entities resident or domiciled abroad.

*What are the main ongoing compliance requirements?*

The activities carried out by financial institutions are subject to several limitations and restrictions. In general terms, such limitations and restrictions are related to granting credit, risk concentration, investments, conditional operations, loans in and trading with foreign currency, administration of third-party funds and microcredit finance and payroll deduction credit.

*What are the penalties for failure to be authorized?*

Carrying on activities that are not of financial institutions and other entities authorized to operate by the Central Bank and the Brazilian Securities Commission (CVM) may subject the offender to criminal sanctions, in addition to civil and administrative penalties.

**Regulated activities**

*What finance and investment activities require authorization?*

The main types of financial institution in Brazil are as follows.

**Investment banks**

Investment banks are financial institutions of a private nature specializing in:

- operations of temporary equity participation;
- financing production activities, providing fixed or working capital; and
- managing third parties' assets.

Investment banks are also allowed to:
• practice, on their own account or at the request of a third party, sale and purchase operations of (a) precious metal and (b) bonds and securities;
• operate, on their own account or under the request of a third party, in stock exchange and future exchange markets (under a specific authorization from the Brazilian Securities Commission (CVM));
• operate under all kinds of credit granting to finance fixed or working capital;
• participate in bonds and securities issuance, subscription to resale and distribution processes (under a specific authorization from CVM);
• operate in the foreign exchange market (under a specific authorization from the Central Bank);
• coordinate the reorganization of companies or group of companies by means of consulting services, acquisition of equity stake and/or financing; and
• manage companies, the corporate purposes of which are directly linked with financial market operations.

Commercial banks

Commercial banks are financial institutions, of private or public nature, specializing in:
• short- and medium-term financing for the supply of capital to individuals, commerce and industry;
• cashing of drafts;
• granting credit facility;
• collecting cash and time deposits;
• fund raising to perform on lending operations; and
• acting as service providers, including services provided through convention with other institutions.

Securities brokers (CTVM)

Securities brokers are financial institutions of a private nature specializing in:
• operating in stock exchanges;
• subscribing solely or jointly with other authorized companies to resale bonds and securities;
• intermediating public offers and distributing bonds and securities;
• purchasing and selling bonds and securities for themselves or for third parties, with due regard to the regulation issued by CVM and Central Bank;
• managing portfolios and the custody of bonds and securities;
• being responsible for the subscription, transfer and authenticity of:
  • endorsement;
  • split of portfolios;
• receipt and payment of redemption proceeds; and
• interest and other incomes related to bonds and securities;
• acting as trustee;
• incorporating, organizing and operating funds and investment clubs;
• incorporating investment companies – foreign capital and administration of their respective portfolios of bonds and securities;
• acting as issuer agents of certificates and share book entering services;
• issuing certificates of deposit for shares;
• intermediating foreign exchange transactions;
• purchasing and selling precious metal, for themselves or for third parties, according to Central Bank's regulation;
• operating in commodities and future exchange, for themselves or for third parties, according to Central Bank's and CVM's regulation;
• intermediating, advising and giving technical assistance to transactions and activities related to the capital and financial markets; and
• practicing other activities authorized by CVM and Central Bank.

Securities dealerships (DTVM)

Securities dealerships are financial institutions of a private nature specializing in:

• subscribing solely or jointly with other authorized companies to resale bonds and securities;
• intermediating public offers and distribution of bonds and securities;
• purchasing and selling bonds and securities for themselves or to third parties, with due regard to the regulation issued by CVM and Central Bank;
• managing portfolios and the custody of bonds and securities;
• being responsible for the subscription, transfer and the authenticity of
  • endorsements;
  • splits of portfolios;
  • receipt and payment of redemption proceeds; and
  • interest and other related to bonds and securities;
• acting as trustee;
• incorporating, organizing and operating funds and investments clubs;
• incorporating investment companies – foreign capital and administration of their respective portfolios of bonds and securities;
• acting as an issuer agent of certificates and share books entering service;
• intermediating foreign exchange transactions;
• purchasing and selling precious metals, for themselves or for third parties, according to Central Bank's and CVM's regulation;
• operating in the barter exchange for themselves or for third parties, according to Central Bank's and CVM's regulation;
• intermediating, advising and giving technical assistance to transactions and activities related to the capital and financial markets; and
• practicing other activities authorized by CVM and Central Bank.

Are there any possible exemptions?

No.

Do any exchange controls or other restrictions on payments apply?

Where loans (and certain other financial transactions) are entered into with Brazilian companies as borrowers, the main financial terms of the loan must be registered with the Central Bank under the Module of Registry of Financial Transaction (Módulo de Registro de Operações...
Financeiras – ROF) of the Central Bank Data System and the funds must be paid into Brazil. This registration with the Central Bank allows borrowers to make payments of principal, interest, cost, fees, expenses and commissions in relation to the loan.

Investments made by foreign residents in the Brazilian financial or capital markets have to be registered with the Central Bank in the ‘Portfolio’ Module of the Central Bank Data System once funds enter into Brazil. This registration allows foreign investors to repatriate the principal of the investment and any gain relating thereto.

Investments made by foreign residents in the capital of Brazilian companies outside the Brazilian financial or capital markets have to be registered with the Central Bank in the Module of Foreign Direct Investment (Módulo de Investimento Estrangeiro Direto – IED) of the Central Bank Data System once funds enter into Brazil. This registration allows foreign investors to repatriate the capital and receive payments of dividends and other related payments abroad.

Other payments involving remittances of funds abroad have to be carried out by institutions authorized by the Central Bank to operate in the foreign exchange market and are subject to certain controls.

There are no currency controls expressly applicable to the Brazilian real.

What are the rules around financial promotions?

Rules

A communication of an invitation or inducement to engage in investment activity made by a person in the course of business may only be done by an entity authorized for such purpose by the Central Bank of Brazil or the Brazilian Securities Commission (CVM).

Exemptions

Brazilian securities legislation does not specifically regulate the offer, to Brazilian resident investors, of securities issued, placed, distributed and negotiated abroad (Foreign Securities). As a result of Brazilian legal restrictions as to the public offer of securities, Foreign Securities may not be offered/negotiated in the Brazilian capital markets. Foreign Securities may only be offered to investors resident in Brazil on a private basis, by means of individual/specific identification and assessment, as an opportunity for investment abroad, provided that the relevant private offer does not involve any kind of public communication services, any type of offices/premises open to the public in general or any brokers/dealers that indiscriminately contact investors.

On 30 September 2005 CVM enacted the Guidance Opinion No. 32 (“Opinion 32”) aiming at, generally speaking, reporting its understanding on the qualification of an offer of securities as public when the Internet is adopted as a means of communication.

The Opinion 32 restates CVM’s understanding that the use of the Internet to disclose an offer of securities qualifies, as a general rule, the offer as a public one. Some situations may, however, be taken into consideration so that the offer will not be regarded as public. Among them, Opinion 32 refers to the following: (a) the webpage is protected in order to avoid the access of the public in general to information contained therein; (b) the non-existence of advertising about the webpage to the public by any means of communication; and/or (c) existence of clear indication that the webpage was not created to the public in general.

On that same date, CVM further enacted the Guidance Opinion No. 33 (“Opinion 33”) aiming at reporting its understanding on the:

- qualification of a securities offer as public when the issuer is located outside Brazil; and
- need of a registration at CVM of those agents that intend to mediate, in Brazil, transactions involving securities issued and negotiated outside Brazil to investors residing in Brazil.

According to Opinion 33, the mediation of securities issued and distributed abroad to Brazilian investors by entities incorporated and located abroad is only authorized – without the need of any registration or notification – on a private basis and provided that the:

- approach activities aiming at the Brazilian investors are carried out abroad; and
- operation is not characterized as a public offer.

If entities incorporated and located abroad intend to mediate securities issued and distributed abroad to Brazilian investors with regard to activities carried out in Brazil, they must:
be registered with CVM; or

contract a member of the so-called securities distribution system to perform the operation in Brazil.

If the offer qualifies as public, both the issuer and the issuance are subject to Brazilian registration rules.

Opinion 33 further clarifies that, for an offer of securities issued abroad not to qualify as addressed to the public residing in Brazil when made through the internet, the following situations, in addition to those provided for in Opinion 32, would be taken into consideration:

- the existence of a notice of clear content and easy access clarifying that the offer is addressed only to the countries where the information provider or the issuer is authorized to offer securities (listing the relevant countries);
- effective measures to prevent access by Brazilian investors;
- a direct or indirect indication (provided that it is sufficiently clear) that the webpage was not created for Brazilian investors (the disclosure of economic forecasts in Brazilian currency or the inclusion of Brazil among the listed countries on any form or, furthermore, the comparison between the issuer of securities and Brazilian issuers are all considered an indication that the page is also directed to investors residing in Brazil); and
- the non-existence, even in a language other than Portuguese, of text to target Brazilian investors.

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

In very broad terms there are two main types of legal entities in Brazil: the limited liability partnership (limitada) and the corporation (sociedade anônimo), both of which are body corporates with separate legal personality and which limit the liability of their members. Corporations can be privately held or publicly held depending on whether their shares are offered to the public.

Usually, the type of legal entity used to incorporate a financial institution is regulated by the Central Bank of Brazil (eg commercial banks may only be incorporated as a corporation)

**Funds**

Under Brazilian law, funds are considered as an ownership right shared by more than one person or legal entity (referred to under Brazilian law as condominums). There is a variety of different funds that are regulated by the Brazilian Securities Commission (CVM). The main difference between them is the type of investments they are allowed to make: for example, there are real estate funds, general investment funds, private equity funds and securitization funds among others.

**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes, with the approval of the Central Bank of Brazil and other approvals, as the case may be (eg the approval of the President in the case of foreign investment).

**FinTech**
FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Before the enactment of CMN Resolution No. 4,656 and CMN Resolution No. 4,657, both dated as of April 26, 2018, which regulated the activities of financial technology companies that operate in the credit market, a financial institution duly authorized by the Central Bank of Brazil was required to mediate the transactions between lenders and borrowers, while the non-bank lending platform only acted as a corresponding agency of the bank. However, with the enactment of the above-mentioned resolutions, these startups were allowed to grant credit without the intermediation of a bank. These regulations came to create a healthier framework for the development and strengthening of FinTechs in Brazil. In addition, by regulating this kind of activity, the Central Bank hopes to encourage competition within this sector and, consequently, offer more competitive interest rates.

Also, as per the approved regulation, FinTechs could be structures as (i) Direct Credit Companies, which will carry out operations with their own resources through an electronic platform; or (ii) Interpersonal Loans Company, focused on financial intermediation (peer-to-peer). Furthermore, on October 29, 2018, the Federal Government enacted Decree No. 9,544, authorizing the foreign investment up to 100% in the capital stock of Direct Credit Companies or Interpersonal Loans Company.

Blockchain, smart contracts and cryptocurrencies

What is Blockchain?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called "hashes".

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or
third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so called ‘Oracles’. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

Brazilian Law No. 12,865/2013 defines cryptocurrency as the value stored in electronic devices or systems that allowed the user to make a payment in a transaction. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

Initial coin offerings (ICOs) are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture. ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security, or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical
server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

On April 26, 2018, the CMN enacted CMN Resolution No. 4,658, as amended, which provided for the obligation of financial institutions and other institutions authorized to function by the Central Bank, including Credit FinTechs, to implement cyber security policies and established requirements to hire data, computing processing and storage services in the so-called “clouds”.

This Resolution became effective on the date of its publication and financial institutions and other institutions authorized to function by the Central Bank, including Credit FinTechs, had a deadline of May 6, 2019 to implement the new security, course of action and prevention policies for incidents related to cyber environment.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The basic structure of the Brazilian financial system (Sistema Financeiro Nacional) was established by Law No. 4.595, which created the CMN (as defined below) and granted the Central Bank, among other things, the powers to issue money and control credit.

MAIN REGULATORY AGENCIES

The Brazilian financial system (Sistema Financeiro Nacional) consists, among others, of the following regulatory and fiscal bodies:

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- Central Bank of Brazil;
- Brazilian Securities Commission (Comissão de Valores Mobiliários or CVM);
- Brazilian Council of Private Insurance (Conselho Nacional de Seguros Privados – CNSP);
- Superintendence of Private Insurance (Superintendência de Seguros Privados or SUSEP); and
- Complementary Pensions Secretariat (Superintendência Nacional de Previdência - PREVIC).

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THE CENTRAL BANK

Law No. 4,595 granted the Central Bank powers to implement the monetary and credit policies established by the CMN, as well as to supervise public and private sector financial institutions and to apply the penalties provided for in law, when necessary. According to Law No. 4,595, the Central Bank is also responsible for, among other activities:

- controlling credit and foreign capital;
- receiving mandatory payments and voluntary demand deposits from financial institutions;
- carrying out rediscount operations and providing loans to banking institutions;
- functioning as the depositary for official gold and foreign currency reserves;
controlling and approving the operations, the transfer of ownership and the corporate reorganization of financial institutions;

- the establishment of transfers of principal places of business or branches (whether in Brazil or abroad); and

- requiring the submission of periodical and annual financial statements by financial institutions.

The President of the Central Bank is appointed by the President of Brazil, subject to ratification by the Federal Senate, and holds office for an indefinite period of time.

**THE CVM**

The CVM is a government agency of the Ministry of Economy, with its headquarters in Rio de Janeiro and with jurisdiction over the whole Brazilian territory. The agency is responsible for implementing the securities policies of the CMN and is able to regulate, develop, control and supervise this market strictly in accordance with the Brazilian Corporate Law and securities laws.

The CVM is responsible for regulating the supervision and inspection of publicly-held companies (including with respect to disclosure criteria and penalties applicable to violations in the securities market), the trading and transactions in the securities and derivatives markets, the organization, functioning and operations of the stock exchanges and the commodities and futures exchanges and the custody of securities.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**ELECTRONIC PAYMENT PLATFORMS**

Law No. 12,865/2013 regulates the payment schemes and payment institutions, which have become part of the Brazilian Payments System. A number of FinTech businesses are offering electronic payment platforms to rival the traditional payment systems.

**PEER-TO-PEER LENDERS**

The CMN approved on April 26, 2018, resolutions No. 4,656 and 4,657, regulating the activities of financial technology companies that operate in the credit market and enabled these companies, which used to operate as banking correspondents in the credit market, to grant credit without the intermediation of a bank. The new rules applied immediately to these entities and allowed interested companies to start the authorization process.

As per the approved regulation, FinTechs could be structures as (i) Direct Credit Companies, which will carry out operations with their own resources through an electronic platform; or (ii) Interpersonal Loans Company, focused on financial intermediation (peer-to-peer).

Furthermore, on October 29, 2018, the Federal Government enacted Decree No. 9,544, authorizing the foreign investment up to 100% in the capital stock of Direct Credit Companies or Interpersonal Loans Company.

**Regulation of payment services**

**GENERAL OVERVIEW**

A payment institution in Brazil is a legal person subject to the Central Bank's provisions, adhering to one or more payment schemes, having as main or ancillary activity one or more of the following (a Payment Institution):

- providing cash-in and cash-out services of the funds held on payment accounts;

- performing or facilitating payment instructions related to definite payment service, including transfers originated from or intended for a payment account;

- managing payment accounts;

- issuing payment instruments;

- acquiring payment instruments;

- remit funds;

- converting physical or book-entry currency into e-money, or vice-versa, acquiring the acceptance or managing the use of e-money;
and

- other activities related to payment services, designated by the Central Bank.

LEGAL FRAMEWORK

Payment Institutions in Brazil are subject, primarily, to the following laws and regulations:

- Law No. 12,865/2013, as amended, regulates the payment schemes and payment institutions, which have become part of the Brazilian Payments System (SPB);
- Resolution No. 4,282/2013 presents a guideline for the regulation of the Central Bank regarding payment schemes and payment institutions;
- Central Bank Circular No. 3,680/2013, as amended, regulates payment accounts;
- Central Bank Circular No. 3,681/2013, as amended, regulates the risk management, minimum capital requirements and governance of payment institutions, among others;
- Central Bank Circular No. 3,682/2013, as amended, regulates payment schemes within the SPB;
- Central Bank Circular No. 3,885/2018, as amended, regulates payment institutions;
- Central Bank Circular No. 3,856/2017 provides for the internal audit activity in the institutions of payment;
- Central Bank Circular No. 3,704/2014 regulates the account held at the Central Bank regarding e-money and the performance of the payment institutions and transfer of reserves system (Sistema de Transferência de Reservas – STR);
- Central Bank Circular Letter No. 3,949/2019 provides clarifications and models regarding the procedures to request authorization for payment schemes;
- Central Bank Circular Letter No. 3,897/2018 provides models of necessary documents to support the proceedings addressed in Central Bank Circular No. 3,885/2018;

CATEGORIES

Under Article 4 of Circular No. 3,855, payment institutions are classified in the following categories, according to the services that will be rendered:

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>SERVICES RENDERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer of e-money</td>
<td>• Manages pre-paid payments account of final users</td>
</tr>
<tr>
<td></td>
<td>• Provides e-money payment transactions</td>
</tr>
<tr>
<td></td>
<td>• Accredits the acceptance of e-money with settlement in payment account managed by the issuer</td>
</tr>
<tr>
<td></td>
<td>• Converts the resources into physical and scriptural currencies, or vice versa</td>
</tr>
<tr>
<td>Issuer of post-paid payment instrument</td>
<td>• Manages post-paid payment account of final payer users</td>
</tr>
<tr>
<td></td>
<td>• Provides payment transactions</td>
</tr>
<tr>
<td>Accrediting entity</td>
<td>• Does not provide payment account</td>
</tr>
<tr>
<td></td>
<td>• Enables recipients to accept payment instruments issued by a payment institution or financial institution member of a same payment scheme</td>
</tr>
</tbody>
</table>
OPERATIONS

According to Circular No. 3,855, the essential conditions for a Payment Institution to operate are:

- due incorporation according to the current rules and regulations;
- Central Bank authorization (only for payment institutions that operate with a volume greater than R$500 million in payment transactions or R$50 million in funds held in prepaid payment account for any given period of 12 months); and
- compliance with the minimum capital requirements in case the payment institution is authorized by the Central Bank.

Application of data protection and consumer laws

BRAZILIAN CONSUMER DEFENSE CODE

Financial activities are also generally subject to the restrictions of the Consumer Defense Code and certain other related regulations from the Central Bank. In 1990, the Brazilian Consumer Defense Code was enacted to establish rigid rules to govern the relationship between product and service providers and consumers with the overall aim to protect final consumers. In June 2006, the Brazilian Supreme Court of Justice ruled that the Brazilian Consumer Defense Code also applies to transactions between financial institutions and their clients. Financial institutions are also subject to specific regulation from the National Monetary Council (CMN), which regulates the relationship between financial institutions and their clients. CMN Resolution No. 3,694 dated March 26, 2009, as amended by CMN Resolution No. 3,919 dated November 25, 2010 and CMN Resolution No. 4,283 dated November 4, 2013, established new procedures with respect to the settlement of financial transactions and to services provided by financial institutions to clients and the public in general, aimed at improving the relationship between market participants by fostering additional transparency, discipline, competition and reliability on the part of financial institutions. The new regulation consolidates all the previous related rules. The main changes introduced by the Consumer Defense Code are described below.

- Financial institutions must ensure that clients are fully aware of all contractual clauses, including responsibilities and penalties applicable to both parties, in order to protect the counterparties against abusive practices. All queries, consultations or complaints regarding agreements or the publicity of clauses must be promptly answered, and fees, commissions or any other forms of service or operational remuneration cannot be increased unless reasonably justified (in any event these cannot be higher than the limits established by the Central Bank).
- Financial institutions are prohibited from transferring funds from their clients' various accounts without prior authorization.
- Financial institutions cannot require that transactions linked to one another must be carried out by the same institution. If the transaction is dependent on another transaction, the client is free to enter into the latter with any financial institution it chooses.
- Financial institutions are prohibited from releasing misleading or abusive publicity or information about their contracts or services. Financial institutions are liable for any damage caused to their clients by their misrepresentations.
- Interest charges in connection with personal credit and consumer directed credit must be proportionally reduced in case of anticipated settlement of debts.
- There must be adequate treatment for the elderly and physically disabled.

DATA PROTECTION

Brazil enacted the Brazilian General Data Protection Law (Federal Law no. 13,709/2018 or "LGPD") on August 15, 2018. The LGPD is Brazil's first comprehensive data protection regulation and it is largely aligned to the EU General Data Protection Act ("GDPR"). Certain LGPD provisions were later amended to, among other modifications, create the National Data Protection Authority ("ANPD") and postpone its effectiveness to August 2020, rather than February 2020, as set forth when the LGPD was first published.

The LGPD applies to any processing operation carried out by a natural person or a legal entity, of public or private law, irrespective of the means used for the processing, the country in which its headquarter is located or the country where the data are located, provided that:

- The processing operation is carried out in Brazil;
• The purpose of the processing activity is to offer or provide goods or services, or the processing of data of individuals located in Brazil; or

• The personal data was collected in Brazil.

LGPD provides rights to data subjects and several obligations to the processing of personal data (defined as any information related to an identified or identifiable natural person). LGPD also imposes obligations to be observed prior to international transfer of personal data as well as notification requirements in scenarios of data breaches which may cause relevant risk or damage to data subjects.

Prior to the LGPD, data privacy regulations in Brazil consisted of various provisions spread across Brazilian legislation. For example, Federal Law no. 12,965/2014 and its regulating Decree no. 8,771/16 (together, the Brazilian Internet Act), which imposes some requirements regarding on security and the processing of personal data and other obligations on service providers, networks and applications providers, as well as rights of Internet users.

Furthermore, general principles and provisions on data protection and privacy are set forth in the Federal Constitution, in the Brazilian Civil Code and other specific laws and regulations that address particular types of relationships (eg Brazil's Consumer Defense Code and labor laws), particular sectors (eg financial institutions, health industry and telecommunications) and professional activities (eg medicine and law).

Specially in relation to finance institutions, Resolution no. 4,658/2018 of the Central Bank imposes cyber security requirements and set forth standards for contracting data processing services, such as storage and cloud computing services. The provisions of such Resolution must be observed by financial institutions and other institutions authorized to operate by the Central Bank of Brazil.

Money laundering regulations

Brazilian Law No. 9,613, of March 3, 1998, as amended by Law No. 12,683, of July 9, 2012 (the Anti-Money Laundering Law) plays a major role for those engaged in banking and financial activities in Brazil. The Anti-Money Laundering Law sets forth the definition and the penalties to be incurred by persons involved in activities that comprise the laundering or concealing of property, rights and assets, as well as a prohibition on using the financial system for these illicit acts.

In addition, the Brazilian Anti-Money Laundering Law created the Financial Activity Control Council (Conselho de Controle de Atividades Financeiras or “COAF”). The main role of the Financial Activity Control Council is to promote cooperation among the Brazilian governmental bodies responsible for implementing national anti-money laundering policies, in order to stem the performance of illegal and fraudulent acts. Their activities also include imposing administrative fines and examining and identifying suspected illegal activities pursuant to the Anti-Money Laundering Law.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

ACCELERATORS

There are various incubators or accelerators in the Brazilian market which offer support, facilities and funding for startups, often in return for an equity stake. For example, Bradesco, one of the largest private banks in Brazil, has an innovation program that selects startups producing solutions adjustable to the financial market (known as inovaBra) and maintains a corporate venture (through an investment fund) to invest in such companies. Other banks have similar initiatives, such as the Cubo coworking by Itaú and Redpoint eVentures and the competition Fintech Venture Day sponsored by Santander InnoVentures (the bank's FinTech investment fund), or the recently launched “Labbs” by Banco do Brasil (which is a platform developed to connect the bank to start-ups).
Venture capital and debt

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company’s assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

Warehouse and platform funding

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV) or a fund (FIDC). The loan is secured on the assets acquired by the SPV or the FIDC from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Senior bank debt and capital markets funding

Senior bank debt

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

Capital markets funding

Brazil has both debt and equity capital markets which are accessible to businesses (usually of a certain size and as long as it is incorporated as a corporation (sociedade anônima), as opposed to a limited liability company (limitada)).

Furthermore, a FinTech company may decide to offer either a full public offer of securities or a public offer with limited marketing efforts.

On 16 January 2009, CVM enacted Instruction No. 476 which establishes that a public offering of certain securities will no longer be subject to registration with CVM or have to comply with CVM provisions relating to public offerings of securities, if they comply with the following requirements (limiting, in general, their marketing efforts) namely:

- involve one of the securities mentioned in Instruction No. 476, including, but not limited to commercial notes, banking credit certificates that are not the responsibility of a financial institution, debentures not convertible into shares, real estate or agribusiness rights certificates issued by securitization companies registered with the CVM as publicly-held companies, quotas of close-ended investment funds and financial notes (letras financeiras);
- be only targeted to qualified investors (as defined in the applicable regulation of CVM);
- be mediated by members of the securities distribution system;
- be marketed to a maximum of 75 qualified investors and subscribed or acquired by no more than 50 qualified investors; and
- not involve marketing activity through stores, offices and establishments open to the public or public communication services.

Public offers to any other type/number of investors are not covered by that exemption and have to comply with the applicable requirements of CVM, including the preparation of a full prospectus on the issuer and the transaction.

Incentives and reliefs

Recently, Brazilian tax authorities have regulated angel investors through the application of tax regimes in respect of the capitalization of companies. Under Normative Ruling RFB No. 1,719/2017, the seed investor is entitled to earn income from capital it has invested which is subject to withholding income tax at rates varying from 15% to 22.5%, depending on the length of the investment. This type of angel investment is treated like a financial market investment and not as an equity contribution, as would be the norm and which otherwise...
would make it subject to dividend payments which are not subject to withholding tax.

With respect to tax incentives for FinTechs, there are no specific tax benefits for this sector but some general tax incentives may apply, such as:

- FinTech businesses with annual (12-month period) gross revenue of up to BRL$4.8 million (four million and eight hundred thousand Brazilian Reais) may be subject to taxes over its gross revenues under a simplified tax regime called 'Simples Nacional', provided that certain thresholds set in the legislation are complied with. Simples Nacional is an optional taxation regime designed to simplify the collection of taxes of micro or small businesses which allows the collection of municipal, state and federal taxes at simplified standard rates based on the monthly gross revenue of the company.

- Certain Brazilian municipalities grant reduced service tax rates from 5% to 2% to attract new businesses. FinTechs which are typical service providers (and not financial institutions) may take advantage of this incentive by setting up operations in those municipalities.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

In Brazil, there are three potential pieces of regulation that affect this market. First, there is the general rule for the assignment of rights set out in the Brazilian Civil Code. In relation to financial institutions, certain resolutions and circulars from the Central Bank of Brazil also impose restrictions on this type of activity. Finally, as most of the purchasers of this type of asset are investment funds (known as investment funds in credit rights (Fundo de Investimento em Direitos Creditórios, or FIDC), the applicable regulation of the Brazilian Securities Commission (CVM) is also relevant.

The Brazilian Civil Code allows creditors in general to assign their rights, provided there is no limitation arising out of the nature of the credit, the applicable laws or the contractual relationship between them and the debtor. It also imposes certain formalities in relation to the transaction documentation. In this respect, an assignment is only binding as against third parties if it is executed through a public document (ie a document issued by a competent Registry) or a private instrument with the place and date of its execution indicated, the purpose of the business specified and the parties (assignee and assignor) clearly identified. Also, the agreement (or another document evidencing the assignment) has to be registered with the competent Registry of Deeds and Documents in Brazil. Finally, the Brazilian Civil Code prescribes that the assignment is only valid as against the underlying debtor that is notified of the assignment. It is important to stress that, unless otherwise provided for in the original agreement, the prior approval of the debtor is not necessary. The debtor has only to be notified of the assignment, by any means legally possible.

Brazilian Central Bank regulation also plays an important role. Central Bank Regulations are basically divided into two categories: regulations relating to situations where the assignee is another financial institution and those relating to situations where the assignee is not a financial institution. There are some important differences between the two categories. First, if the assignee is not a financial institution, the assignment may not benefit from the co-obligation of the assignee (ie the assignee is not responsible for the default of the underlying debtor). Secondly, the purchase price paid by a non-financial institution may not be in instalments. In this case, the payment has to be made with immediately available funds at the date of the financial settlement of the transaction. Finally, and maybe most importantly, the repurchase of the assigned credits is not allowed. These restrictions are generally not applicable to transactions with FIDCs.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or a portfolio of loans. These issues are often covered as part of a due diligence exercise. Some of the key considerations include:


- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

In addition, Resolution No. 3,533 from the National Monetary Council (CMN) dated 31 January 2008, provides changes to the manner in which assigned credit rights are to be treated in the books of financial institutions (pursuant to CMN Resolution No. 3,809 of 28 October 2009). In accordance with Resolution No. 3,533, if the assignor substantially retains the risks and benefits of the assigned credits, such credits may not be recorded as off-balance sheet loans. This provision is applicable to:

- assignments with repurchase commitments;
- assignments in which the assignor undertakes the obligation to compensate the assignee for losses; and
- assignments made jointly with the acquisition (or subscription) of subordinated shares in FIDCs by the assignor.

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**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of infrastructure assets varies in Brazil according to the class of the assets. Some assets are completely owned by the government and some assets are owned by private companies. As state-owned companies are facing difficulties for investing in infrastructure, the government is opening space for investment in the sector to private entities, by means of concessions and public-private partnerships. Currently, approximately two thirds of the total invested in infrastructure in Brazil comes from the private sector.

Even with the increase in the participation of private companies, a large part of the funding for infrastructure projects is still provided by public banks, especially the Brazilian Development Bank (Banco Nacional de Desenvolvimento Econômico e Social, or BNDES).

The key sectors are considered below.

**Energy**

In the energy infrastructure, the private companies already have a significant role. The government does not invest directly in energy, providing the investments through the state-owned companies, especially PETROBRAS and ELETROBRAS, companies that hold a large influence in energy projects.

In several cases, investments in energy projects are provided by means of partnerships between the state owned companies (PETROBRAS and ELETROBRAS) and private companies, increasing the influence of the private companies in energy projects.

Since PETROBAS and ELETROBRAS are passing through a moment of crisis, private investment in energy projects is increasing, a trend which is likely to continue in the coming years.

Notwithstanding the above, in November 2019, President Jair Bolsonaro signed a bill of law authorizing and establishing the rules of ELETROBRAS’ privatization. The Brazilian government intends to capitalize on ELETROBRAS, which has been losing market share in the generation and transmission market. This privatization is expected to take place in the second half of 2020, however, this bill of law must fulfil all legislative rite until its enactment.
Telecoms infrastructure

Brazilian telecommunications infrastructure is privatized. The privatization took place at the end of the 1990s and reduced the public investments. It is now one of the infrastructure sectors where government intervention is lowest.

Recently the bill of law PLC 79/2016 was converted into Law 13,789, dated as of October 3, 2019 (“Law 13,789”), which promoted several changes to the Brazilian General Telecommunications Law and allowed the Brazilian Agency of Telecommunications (ANATEL) to transform current fixed telephone concessions into authorizations, more flexible and less bureaucratic. With the enactment of Law 13,789 important investment values are expected in the coming years.

Transport infrastructure

In transport infrastructure, private investment is predominant. In railroads and ports, public sector investment is secondary, even though still prevalent in railroads investments amounts. In the roads, several concession programs have increased the participation of private companies, but the presence of the public sector is still significant. In the airports, the development of the concession programs is similar to that of the roads. Both the Federal government and private companies provide some investment in waterways as it is a sector with high growth potential during the next years.

The predominance of the private sector in the transport infrastructure is increasing, as the concessions and privatizations are being fostered in roads, railroads, ports and airports.

Other infrastructure

SANITATION

Brazilian state-owned companies and concessions play a dominant role in sanitation infrastructure assets. It is likely that the state-owned companies will face more difficulties with investment in sanitation in the coming years, considering the problems with water resources and the impact of the fiscal adjustments in public investments. In view of this situation, it is anticipated that private investment in sanitation will keep increasing over the coming years. However, the level of difficulty on these projects should be mentioned. In instances, whether by technical issues, abandonment of the concessionaire or other causes, 60% of stalled infrastructure projects are related to sanitation projects. Nonetheless, the sanitation infrastructure projects consist on 9% of the total amount of stalled projects.

HEALTH

In Brazil, investment in the health sector is provided by the government and by private entities, with private investment slightly more prevalent.

EDUCATION

The investments in Brazilian primary education are mainly provided by the public sector. Private investment in primary education corresponds to approximately 20% of the total investment in education assets. However, in higher education, private investment is dominant, corresponding to 75% of the total investment in education. The tendency for the next few years is for higher private sector investment in education.

Are there special rules for investing in energy and infrastructure?

Generally

In Brazil, there are several governmental agencies regulating investment in energy and infrastructure. Every company (including the state-owned companies) which intends to invest in energy and infrastructure is subject to the rules of such governmental agencies.

The governmental agencies have the purpose of establishing internal rules (Decrees and Normative Instructions) for the regulation and supervision of the activities performed by the investors in the specific sectors of Brazilian economy.

Below is the list of the agencies responsible for certain key sectors.
Energy

The main regulatory authorities regarding energy sector include:

- Ministry of Mines and Energy (MME);
- National Policy Council of Energy (CNPE);
- Electricity Sector Monitoring Committee (CMSE);
- Operator of the National Electricity System (ONS);
- Energy Research Company (EPE);
- Electric Power Commercialisation Chamber (CCEE);
- National Water Agency (ANA);
- National Agency of Petroleum, Natural Gas and Biofuels (ANP); and
- Brazilian Electricity Regulatory Agency (ANEEL);

Telecoms infrastructure

The sector of telecommunications is privatized and the private companies are subjected to the rules established by the Brazilian Agency of Telecommunications (ANATEL).

Transport infrastructure

- Waterway transportation is regulated by the National Waterway Transportation Agency (ANTAQ);
- Railroads and roads transportation are regulated by the National Agency of Land Transportation (ANTT); and
- Airways transportation is regulated by the National Civil Aviation Agency (ANAC).

Other infrastructure

The social infrastructure is also regulated by governmental agencies.

Health infrastructure is regulated by the Health Ministry and by the agencies bounded to it, such as the National Agency for Supplementary Health Services (ANS); and the National Health Surveillance Agency (ANVISA).

Education Infrastructure is regulated by the Ministry of Education, which is assisted by the National Education Board.

Last modified 4 Dec 2019 | Authored by Campos Mello Advogados

What is the applicable procurement process?

The procurement process for Energy and Infrastructure in Brazil is provided by means of concessions and public-private partnerships. Both processes are used by the government to increase private investment in energy and infrastructure assets, as state-owned companies are facing severe financial difficulties for new investments.

Below is a more detailed explanation about the forms of investment and funding in energy and infrastructure assets.

Investing in energy and infrastructure

Infrastructure and energy projects may be implemented under several regimes, depending on their nature and in particular whether they legally qualify as public services, activities within the constitutional attribution of the Union or of the States or regulated private activities. Considering the involvement of public and private sectors, all the projects and activities may be defined as a partnership between the government and private entities, which may be formalized under the following regimes:
COMMON CONCESSIONS

The activities designated as public services by the applicable law can only be transferred to private parties through long-term concession agreements or, exceptionally, through permissions (which may be perceived as less stable, but without substantive differences in practice). In both cases, the concession will be a result of a formal public bidding procedure. This procedure is governed by the Federal Law No. 8,987 of 1995.

In common concessions, the private entities are responsible for obtaining the remuneration for the provided services, in a direct relationship with the users of the contracted services.

PUBLIC-PRIVATE PARTNERSHIP

The public-private partnership is governed by the Federal Law No. 11,079 of 2004 and consists of an agreement entered into by and among the government and a private entity for works or services in an amount higher than R$20 million and for a period of more than five years and less than 35 years.

Public-private partnerships are different from the common concessions because of the way the private entities are remunerated. In public-private partnerships, the remuneration of the private entities is usually paid by the public entity which hired the private entity.

There are activities in the infrastructure sector not designated as public services and usually not involving scarce resources or natural monopolies, which may be carried out by private agents with more flexibility. Such activities may be conducted by private entities without the need for a concession or a public private partnership, being subject only to sector-specific regulation and a non-discretionary authorization, on the top of environmental and other legal requirements applicable to business activities in general.

Financing energy and infrastructure

The Brazilian Development Bank (BNDES) plays a dominant role in financing energy and infrastructure assets. Caixa Econômica Federal and Banco do Brasil, the other two large state-owned banks, increased their market share. However, the finance provided by these entities is not sufficient for the investment in infrastructure planned by the government for the coming years, and the investment provided by private companies has become necessary for the execution of the infrastructure projects.

What are the most common forms of funding / investing in energy and infrastructure?

Funding

The most common forms of funding in Brazilian Infrastructure and energy assets include:

- project-finance loans;
- corporate-finance loans; and
- infrastructure debentures.

The majority of the investments in Brazilian energy and infrastructure assets are provided by BNDES. Even in the projects developed under concessions and public-private partnerships, the presence of the state-owned bank is still high.

Investing

Private companies investments in energy and infrastructure assets are usually provided by means of equity.

Restructuring
Enforcement and sanctions

When can there be regulatory investigations?

When the Central Bank considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

The Central Bank also carries out regular audits of authorized firms.

Furthermore, the Resolution No 4,595/2017 sets forth that the implementation of a Compliance Program is mandatory to all the financial institutions or other institutions regulated by the Central Bank.

There is no specific penalty prescribed in this Resolution on institutions that do not implement the Compliance Program. However, it establishes that the Central Bank is authorized to enact other rules and other measures in order to guarantee the enforcement of the mentioned Resolution No 4,595/2017.

The CVM is also entitled to investigate, by launching an administrative procedure, illicit acts and non-equitable practices of administrators, board members and shareholders of listed companies, intermediaries and other participants of the market, pursuant to Law 6,385/1976. This may also result in regulatory sanctions applied by CVM.

What regulatory penalties may apply?

Penalties range from warnings to the intervention or liquidation of the financial institution, depending on the infraction.

The Central Bank may intervene in the operations of a financial institution not controlled by the Brazilian government if there is a material risk for creditors, or if the financial institution frequently violates applicable regulations. The Central Bank may also intervene if liquidation can be avoided or it may perform administrative liquidation or, in some circumstances, require the bankruptcy of any financial institution, except those controlled by the Brazilian government.

In addition to the aforesaid procedures, the Central Bank may also establish the Temporary Special Administration Regime (Regime de Administração Especial Temporária or RAET) which is a less restrictive form of intervention by the Central Bank in private and non-federal public financial institutions and which allows institutions to continue to operate normally.

The RAET may be imposed by the Central Bank in the following circumstances:

- continuous practice of transactions contrary to the economic and financial policies established by federal law;
- the institution fails to comply with the Compulsory Reserves rules established by the Central Bank;
- suffers losses that put its creditor at risk due to inadequate management;
- repeatedly breaches Brazilian banking rules and regulations;
- the institution reckless or fraudulent management;
- the institution faces a shortage of assets; and
- the occurrence of any of the events described above that may result in a declaration of intervention.

The main objective of the RAET is to assist with maintaining the solvency and financial conditions of the institution under special administration and avoid intervention and/or liquidation. Therefore, the RAET does not affect the day-to-day business operations, liabilities or rights of the financial institution, which continues to operate in its ordinary course. The RAET also immediately results in the loss of the term of office of the administrators and members of the Audit Committee of the institution.

There is no minimum term for a RAET, which may cease upon the occurrence of any of the following events:

- acquisition of share control of the financial institution by the Brazilian federal government;
- corporate restructuring, merger, spin-off, amalgamation or transfer of the controlling interest of the financial institution;
• when, at the discretion of the the Central Bank, the institution's situation has normalized; or
• declaration of extra-judicial liquidation of the financial institution.

An administrative liquidation of any financial institution (with the exception of public financial institutions controlled by the Brazilian government) may be carried out by the Central Bank if it can be established that:

• the institution's economic or financial situation is at risk, particularly when the institution ceases to meet its obligations as they become due, or upon the occurrence of an event that indicates a state of insolvency under the rules of Law No. 6,024; the financial institution is deemed insolvent;
• the financial institution has incurred losses that could abnormally increase its unprivileged and exposure of the unsecured creditors;
• management of the relevant financial institution has materially violated Brazilian banking laws, rulings or regulations; or
• upon cancellation of its authorization to operate, the financial institution does not initiate ordinary liquidation proceedings within 90 days or, if initiated, the Central Bank determines that the pace of the liquidation may represent a risk to its creditors. Liquidation proceedings may otherwise be requested, on reasonable grounds, by the financial institution's officers, if its respective bylaws entitle them to this jurisdiction, or by the intervener appointed by the Central Bank in the intervention proceeding, with an indication of the causes of the request.

What criminal penalties may apply?

Following formal investigation, the offenders are subject to criminal penalties in certain cases, including, but not limited:

• insider dealing and misleading statements and practices;
• breaches of the Money Laundering Regulations; and
• conducting regulated activities when not authorized.

These penalties are mainly set out in the Acts on Crimes Against the National Financial System (Act No. 7,492/86); in the Act on Tax Evasion and Crimes Against the Economic Order (Act No. 8,137/90) and in the Anti-Money Laundering Act (Act No. 9,613/98). The penalties may range from fine to imprisonment.

Apart from the above-mentioned criminal Acts, companies are also subject to the administrative and civil sanctions set forth in the Brazilian Clean Company Act (Act No. 12,846/2013), in case of illicit acts committed against the Brazilian or foreign public administration.

According to the mentioned Act 7,492/86, both Central Bank and CVM are entitled to assist the Federal Prosecution Office in the course of the criminal action whenever the crime is practiced in the context of the activities that are subject to the regulators' discipline and inspection.

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There are no stamp, registration or transfer taxes in Brazil. However, financial transactions are subject to the financial transactions tax (IOF), which applies to a variety of transactions, including loans, its transfer or assignment. IOF rates and basis vary depending on the nature of the transaction. The rates range from 0% to a maximum of 25%, depending on the type of financial instrument. The federal
government can modify these rates at any time.

**Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

There are no stamp, registration or transfer taxes in Brazil. However, the IOF rules explained above also apply to the taking, transfer or assignment of a mortgage, debenture or other security. Specific exemptions may apply and a case by case analysis is recommended.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?**

There are no stamp, registration or transfer taxes in Brazil. However, the IOF rules explained above also apply to the taking, transfer or assignment of a debt security. Specific exemptions may apply and a case by case analysis is recommended.

**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Yes, Brazilian tax authorities take priority over any other creditor, except creditors under labor law and labor accident law. However, in the event of a bankruptcy, tax authorities do not take priority over creditors with security over real estate property (i.e. a mortgage).

**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Interest paid under a loan transaction is subject to withholding tax in Brazil.

*If so:*

**What is the rate of withholding?**

For interest payments made under loans granted by Brazilian legal entities, withholding income tax applies at the following rates, which vary in accordance with the term of the loan agreement:

- 22.5% for loans with a maturity term of up to 180 days;
- 20% for loans with a maturity term of between 181 and 360 days;
- 17.5% for loans with a maturity term of between 361 and 720 days; and
- 15% for loans with a maturity term longer than 720 days.

Please note that the payment, credit or remittance of interest amounts outside of Brazil is subject to withholding income tax at a 15% rate, or at a 25% rate, if the lender is domiciled in low haven jurisdictions.

**What are the key exemptions?**

A 0% withholding income tax rate applies to interest amounts paid, credited, or remitted to recipients not resident in Brazil in connection with loan agreements entered into with the sole purpose of stimulating export transactions.

Under certain double tax treaties entered into by Brazil, a lower withholding tax rate applies to the payment, credit, or remittance of interest to a resident of the treaty partner country.

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**
In general, interest payments under debt securities are also subject to the same withholding income tax rules as described above.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

The transfer of funds into Brazil by way of loan between a foreign lender and a domestic borrower is subject to the financial transactions tax (IOF), at a 6% tax rate, if the loan's average maturity term is 180 days or less. For loans with an average maturity longer than 180 days, the IOF is currently reduced to 0%.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Roberto Barros
Partner
Campos Mello Advogados
rbarros@cmalaw.com
T: +55 11 3077 3513
Canada

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Capital markets and structured investments

Issuing and investing in debt securities

*Are there any restrictions on issuing debt securities?*

There are restrictions on the issuance of debt securities in all Canadian jurisdictions.

The rules relating to the issuance of debt securities are the same as those relating to the issuance of equity. Debt securities may not be issued to the public unless a prospectus has been filed with the securities commission of each province and territory in which the securities are proposed to be sold. Debt securities may be issued without filing a prospectus by way of a private placement.

*Last modified 2 Jan 2020*

*What are common issuing methods and types of debt securities?*

Debt securities may be publicly issued by filing a prospectus, or by way of private placement pursuant to an offering memorandum or a term sheet.

Debt securities are usually issued under a trust indenture entered into between the issuer and an indenture trustee that acts as a representative of the subscribers.

Common types of debt securities include bonds, secured and unsecured notes, convertible and non-convertible debentures, and asset-backed securities.

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*What are the differences between offering debt securities to institutional/professional or other investors?*

Prospectus requirements do not create a distinction between institutional/professional or other investors. Investors that meet the prescribed eligibility criteria as an ‘accredited investor’ or a ‘permitted client’ may purchase debt securities offered by way of private placement.

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*When is it necessary to prepare a prospectus?*

Any offering of debt securities requires a prospectus, unless an exemption from the prospectus requirement applies.
What are the main exchanges available?

Most debt securities in Canada are not listed on a securities exchange but trade over-the-counter through alternative trading systems, such as:

- CanDeal;
- CBID/CBID Institutional; and
- Market Axess.

The two principal stock exchanges in Canada both list debt as well as equity securities:

- Toronto Stock Exchange (TSX); and
- TSX Venture Exchange (TSXV).

Issuers seeking to list on either the TSX or TSXV must complete a listing application and various listing requirements.

Is there a private placement market?

Yes, in Canada there is an active private placement market for both bank and non-bank issued debt securities.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers filing a prospectus are responsible for statements made in prospectuses and any misleading statement, omissions or failure to make full, true and plain disclosure could result in civil and criminal liability. Further, purchasers of securities offered by a prospectus that contains a misleading statement also have a right of rescission and a right to bring a civil action against the issuer as well as the directors, the underwriters, the auditors etc.

Issuers must also ensure that the issuance of debt securities does not contravene any covenants made to other lenders or the terms and conditions of any agreement to which the issuer is a party.

Investing in debt securities

Where debt securities are issued under a trust indenture, the indenture trustee usually has the authority to permit certain changes to the terms and conditions without the consent of the security holders. Further, significant changes may be made with the approval of a majority of security holders.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

The establishment and operation of a fund and the offering of fund securities is subject to regulation under the securities legislation and the oversight of the securities commission of each province. Private equity funds and hedge funds are only indirectly regulated unless they file a prospectus; however, such funds may only sell their securities in compliance with available prospectus exemptions, and must
comply with applicable dealer registration requirements.

Each of Canada's ten provinces and three territories has its own securities laws, administered by a local securities regulatory authority. However, in a growing number of areas, including investment fund regulation, the rules have been largely harmonised across the 13 jurisdictions.

The key regulatory instruments that apply to offering fund securities and operating a fund, among other things are:

- **National Instrument 81-101 – Mutual Funds Prospectus Disclosure** (NI 81-101) that regulates projects disclosure requirements for mutual funds;
- **National Instrument 81-102 – Investment Funds** (NI 81-102) that sets out core investment restrictions and fundamental operational requirements;
- **National Instrument 81-105 – Mutual Funds Sales Practices** (NI 81-105) that regulates the sale of mutual funds;
- **National Instrument 81-106 – Investment Fund Continuous Disclosure** (NI 81-106) that sets out continuous disclosure requirements for investment funds; and
- **National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations** (NI 31-103) that regulates registration requirements and the activities of registrants.

**What are common fund structures?**

Common forms of funds include:

- **Open-ended retail funds** – are also referred to as mutual funds and are pooled funds that generally issue securities or units continuously.
- **Closed-ended retail funds** – are also referred to as non-redeemable investment funds. These typically raise a fixed amount of capital through a public offering and many are listed on capital markets.

**What are the differences between offering fund securities to professional / institutional or other investors?**

**Retail funds**

Both closed-ended and open-ended funds that wish to sell securities to the public must file a prospectus and comply with continuous disclosure and other applicable regulatory requirements, as well as exchange rules and policies where the securities of the fund are publicly listed. The funds must also comply with applicable registration requirements under **NI 31-103**.

Foreign funds in many cases will be able to sell its foreign securities to Canadian investors without being registered in Canada, provided the fund:

- sells only to ‘permitted clients’;
- meets all requisite conditions; and
- complies with certain filing requirements (as set out under **NI 31-103**).

**Institutional/professional funds**

Institutional or professional funds are not recognized as a separate category and the offering of securities by an institutional fund would depend entirely on the form of the fund. Where the fund is marketing to the public, it must file a prospectus and comply with continuous
disclosure and other applicable regulatory requirements, as well as exchange rules and policies where the securities of the fund are publicly listed. Alternately, as is more often the case, funds targeted at institutional investors do not offer securities to the public and generally offer securities by way of a private placement under a prospectus-filing exemption.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

Managing investments is a regulated activity in Canada, and dealers and financial advisors must be registered with the applicable securities commission. Similarly, individuals acting on behalf of registered firms must also be registered under the applicable category.

**Investing in funds**

Investment in funds is subject to generally the same risks as investment in any other security.

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**Managing and marketing debt / hedge funds**

**Are there any restrictions on marketing a fund?**

Retail funds can be marketed by registered dealers. Mutual funds are typically distributed to retail investors by either:

- investment dealers; or
- mutual fund dealers.

Exempt market dealers can also market prospectus qualified, open-ended funds to eligible investors under a prospectus exemption. The most common prospectus exemption is the accredited investor exemption. Under this prospectus exemption, securities can be distributed to a purchaser that qualifies as an accredited investor, including:

- an individual who alone or with a spouse has either CA$1 million in financial assets or CA$5 million in net assets;
- an individual who had net income before taxes exceeding CA$200,000 in each of the two most recent calendar years (or CA$300,000 when combined with income of a spouse);
- a Canadian financial institution or Schedule III bank;
- an advisor or dealer;
- the Government of Canada or a jurisdiction of Canada (including crown corporations and agencies);
- a municipality, public board or commission in Canada;
- certain pension funds; and
- certain investment funds.

Institutional investors that are 'permitted clients' may be less relevant for retail funds but are the focus of hedge and non-resident funds.

A firm registered as an investment dealer or mutual fund dealer must generally be a member of a self-regulatory organization. Investment dealers must generally become members of the Investment Industry Regulatory Organization of Canada (IIROC). Mutual fund dealers must generally become members of the Mutual Fund Dealers Association of Canada (MFDA).

Registered dealers, including mutual fund dealers, are subject to ‘know your client’ (KYC), ‘know your product’ (KYP) and suitability requirements that are collectively intended to ensure that purchases of securities are not incompatible with the client’s circumstances, risk tolerance and investment goals.
Under KYC requirements, dealers must take reasonable steps to establish the identity of a client and to ensure that they have sufficient information to meet their suitability obligation. Under suitability requirements, a dealer must obtain, understand and is expected to explain how a proposed investment is suitable for the client in light of the client’s investment needs and objectives, including the client’s:

- time horizon for its investments;
- financial circumstances (including net worth, income, current investment holdings and employment status); and
- risk tolerance for various types of securities and investment portfolios, taking into account the client’s investment knowledge.

Registrants must conduct their own product due diligence and be able to explain to clients the security’s:

- risks;
- key features; and
- initial and ongoing costs and fee.

Are there any restrictions on managing a fund?

NI 31-103 provides for the registration of persons in connection with trading or advising in securities, investment fund management and other related matters.

The key requirement is registration as an investment fund manager (IFM), which is defined as a person or company that directs the business, operations or affairs of an investment fund. IFMs are subject to a statutory duty to act in the best interests of an investment fund. The regulators considered extending this duty of care to other categories of registrants, however, subsequent to an extensive consultation period, the regulators published a set of proposed amendments which impose new requirements, codify best practices in existing guidance, and clarify the client-registrant relationship. These amendments are expected to come into force on December 31, 2019, subject to receiving required provincial approvals, with industry participants being required to comply over a two-year phased transition period.

An IFM that acts as a portfolio advisor or that distributes securities of its own funds must also register as a portfolio manager (PM) or as an exempt market dealer (EMD), respectively. All registrants, including EMDs, must:

- meet minimum capital and insurance requirements;
- adopt written compliance policies and procedures;
- file periodic reports with the principal securities regulator and maintain certain records; and
- identify, disclose and manage conflicts of interests.

Fund managers must disclose, on a quarterly basis, net asset value (NAV) adjustments. In addition, all registrants must file audited financial statements with the regulators. IFMs of funds that are reporting issuers must comply with the requirements of National Instrument 81-102 (NI 81-102), NI 81-106 and NI 81-107.

Dealers and advisors are subject to best execution requirements under NI 23-101 (Trading Rules) and rules regarding soft dollar arrangements under NI 23-102 (Use of Client Brokerage Commissions).

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

The regulation of derivatives in Canada, like securities, is governed by individual provincial regulators. However, provincial regulators have generally enacted uniform regulations in respect of derivatives, which are substantially similar to those in the US and in the EU, all as part of its G20 commitments following the global financial crisis in 2008.
Dealer registration requirements exist to the extent a party is engaged in the 'business of trading derivatives'. There are a number of indicia to indicate if and when a party is considered a dealer and whether or not they are subject to registration requirements.

Over-the-counter derivatives transactions in some jurisdictions in Canada are treated as trading in securities and are thus subject to securities laws. To be exempt therefrom (pursuant to blanket orders in individual jurisdictions), parties to over-the-counter derivatives transactions must represent that they are of a type of sophisticated counterparty that ensures they are aware of and have adequately assessed the risks associated with these types of transactions. There are a number of criteria included in such blanket orders for purposes of determining a party's ability to trade derivatives relating to the type of entity and net worth of any such individual or entity.

What are common types of derivatives?

Derivative contracts are entered into in Canada for a range of reasons including foreign exchange, currency, commodity, hedging and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contracts are widely used in Canada:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contract is based on the value of the underlying assets. The main classes of underlying assets seen in Canada are:

- equity;
- interest rates;
- commodities;
- foreign currency; and
- credit events.

Certain types of standardized over-the-counter derivatives, including interest rate swaps and foreign rate agreements, are also subject to mandatory clearing.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. Canada, in line with the G20 Commitments, has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants. In particular, the new regulations are focused on trade reporting, dealer registration, mandatory clearing and margining to reduce credit and market risk.

In addition, derivatives are subject to normal market and counterparty credit risk and, as a result, are designed solely for sophisticated
Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending Banks

The operation of domestic and foreign banks is governed by the Bank Act (Canada) which requires that a bank receive authorization to carry on banking activities in Canada. The classification of the bank as a Schedule I Bank (Canadian-owned banks), Schedule II bank (foreign bank subsidiaries) or Schedule III bank (foreign banks operating through branches in Canada) determines which provisions of the Act apply to such bank.

Section 510(1) of the Bank Act (Canada) provides that:

‘Except as permitted... a foreign bank or an entity associated with a foreign bank shall not (a) in Canada, engage in or carry on (i) any business that a bank is permitted to engage in or carry on under this Act, or (ii) any other business; (b) maintain a branch in Canada for any purpose; (c) establish, maintain or acquire for use in Canada an automated banking machine, a remote service unit or a similar automated service, or in Canada accept data from such a machine, unit or service; or (d) acquire or hold control of, or a substantial investment in, a Canadian entity.’

An exemption to section 510(1) is found in section 524(1) of the Act which permits a foreign bank to establish a branch in Canada upon approval from the Minister of Finance.

A foreign bank can avoid the application of the Bank Act (Canada) while making loans to Canadian borrowers by ensuring that the bank's activities in Canada do not amount to engaging in or carrying on business in Canada. This is a question of fact and depends on the circumstances of each individual situation.

Foreign banks may also establish Representative Offices in Canada with the required approval under the Bank Act and may promote the services of the foreign bank and act as a liaison with non-Canadian Offices of the foreign bank, but may not otherwise carry on business.

Borrowing

Borrowers are generally not regulated; however, some regulations apply if the borrower is classified as a consumer, depending on the Province's consumer legislation.

What are common lending structures?

Lending in Canada can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees who fulfil certain roles for the finance parties) and are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.
Loans are structured to achieve specific objectives (e.g. term loans, working capital loans, project facilities and letter of credit facilities).

**Loan durations**

The duration of a loan can vary among:

- a term loan, which is provided for an agreed period of time, usually 3-5 years;
- a revolving loan, which allows for the loan amount to be withdrawn, repaid and redrawn until the maturity date;
- an overdraft, which is provided on a short-term basis to solve short-term cash flow issues; and
- a standby loan, where the lender gives a commitment to advance a specified amount of money on demand or at a future date.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, see [Giving and taking guarantees and security](#).

**Loan commitment**

A loan can also be:

- committed, which means that the lender is obliged to provide the loan if certain conditions are satisfied; or
- uncommitted, which means that the lender has discretion whether or not to provide the loan.

**Loan repayment**

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or on scheduled repayment dates (usually meaning the loan is repayable in full at maturity).

**What are the differences between lending to institutional / professional or other borrowers?**

Generally, there are no differences between lending to institutional/professional borrowers and other borrowers. There may be additional considerations regarding the taking and enforcing of security for secured loans and execution requirements.

**Do the laws recognize the principles of agency and trusts?**

Yes, both principles are recognized as a matter of Canadian law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

**Are there any other notable risks or issues around lending?**

Generally

ENFORCEABILITY

Loan agreements and other finance documents are subject to general contractual principles. Enforcement of contracts is subject to applicable bankruptcy, insolvency, moratorium, reorganization and other similar laws relating to or affecting the enforceability of creditors’ rights generally; general equitable principles and the discretion of courts in granting equitable remedies.
INTEREST

Except with respect to mortgages on real property and, in Québec, hypothecs subject to the provisions of the Civil Code of Québec, a lender may charge any rate of interest pursuant to the Interest Act (Canada), provided that if the rate of interest is payable at a rate or percentage per day, week, month or for any period less than a year, the lender discloses in the agreement the yearly rate or percentage of interest to which the other rate or percentage is equivalent. If such disclosure is not included in the agreement, no interest exceeding the rate or percentage of 5% per annum is chargeable, payable or recoverable on any part of the principal money. In addition, the Criminal Code (Canada) prohibits the charging of annual interest that exceeds 60%. Any rate above 60% is a 'criminal rate' and is illegal. Debtors may use such a finding as a reason to avoid repayment. 'Interest' is broadly defined under the Criminal Code (Canada) and includes all charges and expenses, including fees, fines, penalties and commissions.

ENVIRONMENTAL ISSUES

Lenders must also be mindful of the various environmental liabilities and obligations that apply under federal, provincial and territorial laws to their debtors. In certain circumstances, these liabilities and obligation can extend to the lender. This can arise if the lender is found to have exercised control or direction over the day-to-day operations or financial management of the debtor or becomes the owner of a contaminated site by foreclosure or similar action.

Specific types of lending

For secured lending to individual debtors, lenders should consider the application of various provincial and territorial legislation which protects the rights of spouses. For more information, see Giving and taking guarantees and security.

Standard form documentation

Loan documents and other finance documents are generally the bank's standard form documentation.

Are there any other notable risks or issues around borrowing?

Borrowers should consider the risks associated with defaulting under the loan agreements and ancillary documents and the rights of the lender on such default.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a corporation giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative. Canadian creditors generally rely on the legal opinions of debtors' counsel as to capacity and the enforceability of loan agreements and ancillary documents.

In Québec, the Civil Code of Québec provides various obligations pertaining to the right to grant a security, notably depending on whether the grantor is an individual or a business entity.

Insolvency

Guarantees and security may be at risk of being set aside under Canadian insolvency laws and under provincial fraudulent preference/conveyancing laws if the guarantee or security was granted by a corporation within a certain period of time prior to the onset...
of insolvency. This would be the case if the corporation giving the guarantee or security received considerably less consideration and, as such, the transaction was at an undervalue. Guarantees and security may also be challenged on other grounds relating to insolvency.

**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees can take a number of forms. Two common forms are performance bonds and payment guarantees.

**PERFORMANCE BONDS**

A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.

**PAYMENT GUARANTEES**

A payment guarantee provides that the guarantor will be obligated to pay either all outstanding monies owed under the primary contract or an amount up to a fixed amount if the debtor or obligor fails to make such payments.

**Common forms of security**

The common types of security agreements are as follows.

**GENERAL SECURITY AGREEMENTS (GSAS)**

A GSA normally charges all present and after-acquired personal property of the debtor, but can be limited to specific items of personal property and can include a floating or fixed charge against the debtor’s interest in real property. In Québec, the equivalent of a GSA is a hypothec which charges present and after-acquired movable property (ie personal property).

**PLEDGES**

Pledges require debtors to deliver certain assets, such as securities or negotiable instruments, to the creditor.

**MORTGAGES**

A mortgage charges the real property of the debtor. In Québec, the equivalent of a mortgage is a hypothec which charges immovable property (ie real property).

Additionally, it is possible to grant security over all of the assets of the debtor (which is called in Québec the universality of the assets of the debtor). Granting security over all of a corporation's assets will tend to be achieved by way of a debenture which will include:

- a mortgage over real property (and, in Québec, that would be a hypothec over the universality of all the immovable assets);
- a fixed charge over assets which are identifiable;
- a floating charge over fluctuating and less identifiable assets; and
- an assignment by way of charge over receivables and contracts.

**Are there any other notable risks or issues around giving and taking guarantees and security?**

**Giving or taking guarantees**
To be valid, a guarantee needs to be in writing, signed by the guarantor and provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations will usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this should not be an issue. Also, it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary, for example between the borrower and lender. Guarantees can be executed as deeds to avoid any argument about whether good consideration was provided. Deeds have particular execution requirements which need to be observed.

In Alberta, personal guarantees require compliance with the *Guarantees Acknowledgment Act (Alberta)*. In Saskatchewan, personal guarantees require compliance with *The Saskatchewan Farm Security Act (Saskatchewan)*. Generally, the guarantor needs to appear before a lawyer in Alberta or a lawyer or notary public in Saskatchewan and:

- acknowledge that he or she executed the guarantee; and
- execute the prescribed guarantee certificate in the presence of the lawyer or notary public.

The lawyer or notary public, as applicable, then must complete the prescribed guarantee certificate. Failure to comply with the applicable Act will result in the personal guarantee being unenforceable. In Québec, guarantees or suretyships must comply with the *Civil Code of Québec*.

In most Canadian jurisdictions, corporate legislation permits a corporation to give financial assistance by way of guarantee or otherwise to any person for any purpose, provided it discloses material financial assistance to its shareholders. In some provinces and territories, the corporation must meet the prescribed insolvency test in order to provide financial assistance to an intercorporate group. Under certain circumstances, creditors and minority shareholders may challenge the granting of a guarantee under the oppression provisions of the applicable corporate legislation.

### Giving or taking security

Once granted, security needs to be properly “perfected” before it is valid against third parties. Perfection formalities depend on the location and nature of property subject to the security and can range from having the secured asset delivered to the secured party, registering the security agreement or notice thereof in the applicable provincial registry system, providing notice of the security interest to third parties, or a combination thereof. The registry system and the requirements for registration vary among the provinces and territories. All of the common law provinces have enacted Personal Property Security Acts which have a great deal of similarity in purpose and content. The PPSAs are modelled on the U.S. UCC-9 provisions. Quebec has a comparable regime under the *Civil Code of Quebec*.

Additionally, the priority of a secured party's security interest may be governed by various provincial and federal laws which deal with the taking, perfecting and enforcing of security interests. The determination of priorities among interests created under the various Acts can be a cumbersome process. Generally, a creditor will conduct searches to ascertain whether there are any secured parties who will have priority over its interests in all provinces and territories in which a debtor carries on business or has assets.

There may also be unregistered interests which may take priority over a secured party, including statutory liens. Statutory liens commonly arise from a debtor's obligation to remit amounts collected or withheld on behalf of the government (eg employee deductions for income taxes, pension plan contributions, goods and services taxes, provincial sales taxes and property taxes). These liens are deemed trusts and are usually not registered in any registry system. As such, they may not be identified through conventional searches. Issues regarding statutory liens typically arise when a debtor becomes insolvent or commences a restructuring under the *Bankruptcy and Insolvency Act (Canada)* or the *Companies’ Creditors’ Arrangement Act (Canada)*.

For security interests granted by individual debtors, creditors should consider the application of various provincial and territorial legislation which protects the rights of spouses. Such legislation may affect a secured party's ability to enforce its security against a home or homestead. Generally, this risk can be mitigated by receiving the written consent of the spouse of the debtor at the time the debtor executes the security agreement.

*Last modified 2 Jan 2020*

### Financial regulation
Law and regulation

**What are the main laws and regulations that apply to entities that are involved in finance and investments generally?**

**Generally**

**FEDERAL**

Bank Act (S.C. 1991, c. 46)

Office of the Superintendent of Financial Institutions Act (R.S.C, 1985, c. 18 (3rd Supp.), Part I)


Canadian Securities Administrators (group that co-ordinates securities regulation among the 13 provincial and territorial regulators)

**PROVINCIAL**

Each province and territory has enacted its own securities legislation and has established a regulatory authority to administer it. Many provinces and territories interpret securities laws in the same manner through the adoption of National and Multilateral Instruments. These National and Multilateral Instruments can be found at each province's or territory's respective securities commission website.

Securities Act (Alberta) and Alberta Securities Commission

Securities Act (BC) and the British Columbia Securities Commission

Securities Act (Ontario) and Ontario Securities Commission

Securities Act (Québec), Derivatives Act (Québec) and the Autorité des marchés financiers

**Consumer credit**

**FEDERAL**

Financial Consumer Agency of Canada Act (S.C. 2001, c.9)

**QUÉBEC**

Consumer Protection Act-RSO c.P40

Civil Code of Quebec

**Mortgages**

**FEDERAL**

Canada Mortgage and Housing Corporation Act (R.S.C., 1985, c. C-7)

**QUÉBEC**

In Québec, the equivalent to a mortgage is a hypothec, which is the most common form of securities.

Civil Code of Québec

Regulation No. 29 respecting Mutual Funds Investing in Mortgages (V-1.1, r. 45)

**Corporations**

**FEDERAL**
Canada Business Corporations Act

PROVINCIAL

Each province and territory has its own provincial legislation.

Ontario Business Corporations Act

Alberta Business Corporations Act

Business Corporations Act (Québec) and Civil Code of Québec

Funds and platforms

PROVINCIAL (ONTARIO)

National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (Advisors, Dealers, Investment Fund Managers)

National Instrument 81-101 Mutual Fund Prospectus Disclosure

National Instrument 81-102 Investment Funds

National Instrument 81-104 Commodity Pools

National Instrument 81-105 Mutual Fund Sales Practices

National Instrument 81-106 Investment Fund Continuous Disclosure

National Instrument 81-107 Independent Review Committee for Investment Funds

PROVINCIAL (QUÉBEC)

National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (Advisors, Dealers, Investment Fund Managers)

National Instrument 81-101 Mutual Fund Prospectus Disclosure

National Instrument 81-102 Investment Funds

National Instrument 81-104 Commodity Pools

National Instrument 81-105 Mutual Fund Sales Practices

National Instrument 81-106 Investment Fund Continuous Disclosure

National Instrument 81-107 Independent Review Committee for Investment Funds

Other key market legislation

Investment Industry Regulatory Organization of Canada

Mutual Fund Dealers Association of Canada

PROVINCIAL

Multilateral Instrument 91-101 Derivatives: Product Determination

Multilateral Instrument 96-101 Trade Repositories and Derivative Data Reporting

(ONTARIO)

Instruments 91-301 to 94-101
Regulatory authorization

Who are the regulators?

Provincial (Québec)

The Autorité des marchés financiers is the regulator of the Québec financial sector, notably in the areas of insurance, securities, derivatives, deposit institutions (other than banks) and the distribution of financial products and services, as well as products and services related to insurance, in both retail and wholesale markets. It is also responsible for any enforcement of market abuse and listing regimes.

Self-regulatory organizations (e.g. Montréal Exchange) receive certain delegation of powers from the Autorité des marchés financiers in order to monitor and supervise the conduct of its members, including development of rules and compliance control in respect of these rules.

What are the authorization requirements and process?

Provincial (Québec)

Subject to certain exemptions, any firm/person wishing to act as a dealer, advisor or investment fund in Québec must register with the Autorité des marchés financiers.

In that regard, the Autorité des marchés financiers maintains the Register of firms and individuals authorized to practise.

Certain fees may apply and are payable to the Autorité des marchés financiers depending on the type of services and products, or on the type of registration.

What are the main ongoing compliance requirements?

People who sell or give advice about mutual funds must be registered through the sponsorship of a dealer, with the provincial securities commission in each province where they want to sell mutual funds.

A dealer, or retail distributor, must be registered with the appropriate securities commission(s) and, depending on the jurisdiction and the types of securities the dealer can sell, it may have to be a member of the Mutual Fund Dealers Association (MFDA) or Investment Industry Regulatory Organization of Canada (IIROC). The advisors sponsored by a dealer are also regulated by the MFDA or IIROC, except in Québec where they are regulated by the Chambre de la sécurité financière.

What are the penalties for failure to be authorized?

Provincial (Québec)
Anyone undertaking any regulated activity without being authorized or registered, commits an offence (sometimes criminal) and is liable to be subject to a fine (and in some cases to imprisonment).

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Regulated activities

What finance and investment activities require authorization?

Generally

Foreign investment in certain industry sectors such as telecommunications, transportation, broadcasting and banking will generally require prior approval by the applicable regulatory authority.

INVESTMENT CANADA ACT (CANADA)

Foreign investment in Canada is regulated by the Investment Canada Act (Canada). Non-Canadians who propose to acquire control of an existing Canadian business must either (depending on whether certain prescribed monetary thresholds for the investment are exceeded):

- file a notification prior to the implementation of the investment or within 30 days thereafter; or
- file an application for review prior to implementation of the investment.

Non Canadians who establish a new Canadian business must file a notification.

With certain exceptions, an application for review triggers a pre-closing waiting period (which may be several weeks or longer), meaning that approval of the Minister of Innovation, Science and Industry is required before the transaction may close. [If the investment involves acquisition of control of a cultural business, approval is required from the Minister of Canadian Heritage.] Such approval will be provided if the relevant Minister is satisfied that the transaction will result in a 'net benefit' to Canada. Investors normally must provide commitments in order to secure such approval.

The federal cabinet, in consultation with the Minister of Innovation, Science and Industry, may also order a review of an investment by a non-Canadian where there are reasonable grounds to believe the investment could be injurious to national security. Such a review is possible for foreign investments constituting less than an acquisition of control and regardless of financial thresholds. This applies to a non-Canadian that acquires an interest in or establishes a Canadian business or, in certain circumstances, an entity carrying on all or part of its operations in Canada.

COMPETITION ACT (CANADA)

Where the prescribed financial thresholds are exceeded, the parties must notify the Commissioner of Competition (head of the Competition Bureau) about the proposed transaction and observe the prescribed waiting periods. Completion of the transaction cannot take place unless and until the Commissioner issues an Advance Ruling Certificate (ARC) or waives the requirement to notify, or the statutory waiting period has expired.

Before closing and for up to one year thereafter, the Commissioner may challenge a merger of any size where it is likely to lessen or prevent competition substantially. The Commissioner's challenge is made by way of an application to the Competition Tribunal. The Commissioner typically seeks an order to block a merger or to require divestiture of assets. Parties to a merger may voluntarily seek approval from the Commissioner (in the form of an ARC or “no-action letter”) if there are concerns with respect to the competitive impact of the transaction.

INVESTMENT IN REAL PROPERTY

In Alberta, Saskatchewan, Manitoba and Québec, the investment in farm land by non-Canadians is regulated and restricted. Each province has a different definition of who is considered to be a non-Canadian. In Québec, the investment in farm land by non-residents of Québec
and foreign-controlled entities is also regulated and restricted.

In Prince Edward Island, the investment in land by non-residents of Prince Edward Island is regulated and restricted.

SECURITIES

Any regulated financial activity in Québec requires an authorization from the Autorité des marchés financiers. For instance, any firm providing money or insurance services has to be registered with the Autorité des marchés financiers.

Consumer credit

In addition to federal consumer protection laws, each province and territory in Canada has enacted consumer protection legislation. Generally, consumer protections cannot be waived and the prescribed disclosure must be provided to the consumer prior to entering into an agreement with the consumer (e.g., the total cost of credit or borrowing, as well as any particular fees, must be disclosed to the consumer). Consumer protection laws in some provinces also prohibit clauses that provide that a foreign law governs the consumer agreement or that provide that the consumer is not permitted to bring a class action or be a member of a group bringing a class action.

Are there any possible exemptions?

The Investment Canada Act (Canada) and the Competition Act (Canada) each contain limited exemptions from the application of the Act. Generally, the applicable legislation in each of Alberta, Saskatchewan, Manitoba, Québec and Prince Edward Island set forth certain exemptions regarding the investment in farm land or land, in case of Prince Edward Island. If one of the exemptions does not apply, non-Canadians can apply for an exemption or authorization from the regulatory authority responsible for administering the relevant regime.

Do any exchange controls or other restrictions on payments apply?

There are no exchange controls in Canada and no restrictions on the repatriation of profits (other than requirements relating to withholding tax on dividends etc).

What are the rules around financial promotions?

Rules

‘Financial promotions’ is not a concept used in Canada.

Under Canadian securities laws, a distribution of securities may only be made by way of a prospectus that complies with Canadian securities laws and that has been filed with the Canadian securities regulators, unless a prospectus exemption is available. The securities laws of a province of Canada will apply if securities are sold to a purchaser who is resident in such province or to a purchaser who has sufficient connections to such province to trigger the application of its securities laws.

Canada also has anti-spam legislation (Canada’s Anti-Spam Law (CASL)). Generally, express opt-in consent is required to send commercial electronic messages (including emails, text messages and other electronic messages) to any person in Canada. There must also be compliance with certain content requirements, including those relating to sender details and unsubscribe requests.

Exemptions

Issuers can offer or issue their securities in a manner that is exempt from the prospectus requirements (under National Instrument 45-106 Prospectus Exemptions). The most commonly used prospectus exemption is the exemption that permits a sale of securities only to investors who qualify as accredited investors under Canadian securities laws. There are also the family-and-friends exemption, employee
exemption and the offering memorandum exemption, in addition to others.

Under CASL, there are a few relationships in which there will be implied consent to receive commercial electronic messages, including existing business relationships (i.e., where the person has made a transaction, an inquiry, an application or a written contract for the purchase or barter of products, goods or services). Emails must still comply with the content requirements, including those relating to sender details and unsubscribe requests.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are general partnerships, limited partnerships, limited corporations and unlimited liability corporations. Other legal structures available in Canada for businesses include contractual relationships, such as franchises, joint ventures and license agreements.

Limited liability and tax consequences tend to be the main considerations for most businesses when choosing the appropriate means for undertaking financial or investment activity.

Partnerships

A partnership generally exists when two or more persons carry on business together with a view to profit. The income and losses of the partnership generally flow through to the partners of the partnership.

In a general partnership, each partner is jointly liable for the debts and obligations of the partnership. In a limited partnership, the general partner is liable for the debts and obligations of the partnership and the limited partners are only liable to the extent of their capital contributions (provided they do not take part in the management or control of the business of the partnership).

Corporations

Corporations are considered to be separate legal entities. Shareholders of a limited corporation (denoted by Limited or Ltd., Incorporated or Inc., or Corporation or Corp.) have limited liability and shareholders of an unlimited liability corporation (denoted by Unlimited Liability Corporation or ULC) have unlimited liability. Incorporation can be effected at the federal, provincial or territorial level; however, only the provinces of British Columbia, Alberta and Nova Scotia allow for the creation of an unlimited liability corporation.

A corporation incorporated either provincially or federally must be extra-provincially registered in each province where such corporation carries on business. The ‘carrying on business’ test is specific to each jurisdiction, but typical indicia include whether an entity has any physical presence or assets, resident employees or agents, local phone numbers or traditional advertising activities in the jurisdiction. The registration process in each jurisdiction is relatively straightforward and generally involves some combination of submitting an application, paying a fee, appointing an agent for service, and providing proof of the entity’s existence (e.g., a certificate of status).

Funds

Investment funds tend to take the form of limited partnerships, limited companies and trusts. Persons who act as investment fund managers are generally required to register in the provinces or territories in which the investment fund managers do business. If an investment fund manager does not have a place of business in Canada, it may be exempt from this registration requirement in certain circumstances.

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Is it possible to conduct lending or investment business through a branch or establishment?
Yes.

A non-Canadian entity may conduct business in Canada through a branch office of the non-Canadian entity. The non-Canadian entity will be required to register (with the appropriate authority) as an extra-provincial entity in each province where it carries on business.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Overview

In Canada, FinTech products and services are continually evolving and commonly include, among others, peer-to-peer (P2P) lending platforms, crowdfunding platforms, virtual credit cards, online lenders, robo advisors (i.e. algorithm-driven wealth management and advisory services), online money transfer services and the implementation of digital currency initiatives. These new products and services may use artificial intelligence (AI), machine learning, distributed ledger technology or other technologies to offer a compelling service to clients and customers.

Marketplace lending

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes P2P-type structures often operated through an electronic platform provider, crowdfunding platforms that connect investors with companies looking to raise capital (including from retail investors) and various other financing mechanisms.

It is not uncommon for a marketplace lending platform to raise capital from venture capital funds and/or private equity funds or institutional sponsors.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, deriving an effective funding structure will be particularly important.

A significant issue for any marketplace lender will be navigating the Canadian (and potentially international) regulatory regime(s). For example, depending on the nature of the activities and the manner in which they are conducted, some or all of the following legal regimes, among others, may be relevant to the business:

- securities law (e.g., robo advisory firms, crowdfunding platforms and P2P lending platforms may all be subject to applicable securities laws);
- consumer protection legislation (this may govern the relationship between the lender and its customers);
- payment processing regulation (either by federal or provincial legislation or industry standards and codes);
- anti-money laundering legislation (including the Proceeds of Crime (Money Laundering) and Terrorist Financing Act);
- privacy legislation; and
- data security legislation.

It is imperative that startup marketplace lenders engage appropriate legal counsel and other advisors to assist in establishing a business structure that is both efficient and regulatory compliant from the outset as this will assist the startup in attracting investment and
ensuring it is positioned to reduce potential issues during its growth phase.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned'). Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

There are various definitions of cryptocurrency and many individuals use it in a colloquial sense; however, it can be considered to be a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is
issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a ‘security’ for purposes of applicable laws.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper (or an offering memorandum or prospectus if the token offering constitutes an offering of securities) available to potential purchasers. Any person contemplating an ICO should consult with global legal counsel to ensure that they are complying with all applicable laws, including securities laws, sanctions, anti-money laundering, tax and consumer protection legislation.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by AI that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years. Any business contemplating the use of cloud computing must ensure it has appropriate regulatory, privacy and data security procedures in place.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The regulation of financial products and services is a combination of both federal and provincial regimes, which can often be divergent and overlapping.

GENERAL

There is not currently a comprehensive regime which specifically regulates FinTech in Canada. However, a person carrying on business in the area of financial products and services will be required to comply with a variety of banking, securities, consumer protection and privacy laws.

COMPETITION BUREAU OF CANADA’S MARKET STUDY REPORT: TECHNOLOGY-LED INNOVATION IN THE CANADIAN FINANCIAL SERVICES SECTOR
After conducting an 18 month long study which included holding a FinTech workshop for stakeholders, founders and regulators held in February 2017, the Competition Bureau of Canada published its market study report in December 2017. The report set out 30 recommendations for regulators and policy makers. 19 of the recommendations identified specific, technical improvements in the areas of retail and payment systems, investment dealing and advice, P2P lending and equity crowdfunding while 11 of the recommendations focused on how to strike the right balance between regulation and innovation. Some of the broader recommendations that the Competition Bureau had for regulators are as follows:

- **Principles based regulation** – Regulators should adopt a principles-based approach instead of prescribing exactly how a service must be carried out, which would allow for more flexibility with regards to enforcement as technology continues to change.
- **Function focused regulation** – Regulators should focus on the function that an entity carries out which will ensure that all entities that perform the same function carry the same regulatory burden and consumers have the same protections when dealing with competing service providers.
- **Collaboration** – Regulators should encourage collaboration throughout the sector, using mechanisms such as regulatory sandboxes and innovation hubs.
- **FinTech Policy Lead** – Regulators should identify a FinTech policy lead for Canada in order to facilitate FinTech development to provide industry participations with a one-stop resource for information and encourage greater investment in innovative businesses.
- **Access, Harmonization and Review** – Regulators should promote greater access to core infrastructure and services, continue their efforts to harmonize regulations across jurisdictions in Canada and continue to review their regulatory frameworks frequently.

**CANADIAN SECURITIES ADMINISTRATORS BUSINESS PLAN 2019-2022**

In June 2019, the Canadian Securities Administrators (CSA) published the CSA Business Plan 2019-2022, which includes considering the development and adaptation of the regulatory framework to address challenges brought by emerging technologies as one of the strategic goals. This goal consists of (i) identifying emerging regulatory issues which require regulatory action or clarity, and (ii) developing a tailored and effective regulatory response.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**ELECTRONIC PAYMENT PLATFORMS**

Federally-regulated financial institutions (FRFIs) must comply with payment rules and standards set out in the federal Bank Act. The Office of the Superintendent of Financial Institutions (OSFI) regulates, among other things, the payment processing services of FRFIs. FinTech mobile payment providers are not usually FRFIs, and therefore not subject to OSFI oversight. However, FinTech companies are required to comply with various codes of conduct and standards in Canada’s payment industry, including the Code of Conduct for the Credit and Debit Card Industry in Canada and the Canadian NFC Mobile Payments Reference Model.

In July 2017, the federal Department of Finance issued a consultation paper entitled ‘A New Retail Payments Oversight Framework’, which outlined various aspects of a proposed new framework for regulating retail payments. With limited exceptions, the new proposed framework would apply to any payment service provider (PSP) that is engaged in the following payment functions:

- **provision and maintenance of a payment account** – providing and maintaining an account in the name of one or more end-users for the purpose of making electronic fund transfers;
- **payment initiation** – enabling the initiation of a payment at the request of an end-user;
- **authorization and transmission** – providing services to approve a transaction and/or enabling the transmission of payment messages;
- **holding of funds** – enabling end-users to hold funds in an account held with a PSP until it is withdrawn by the end-user or transferred to a third party through an electronic fund transfer; and
- **clearing and settlement** – enabling the process of exchanging and reconciling the payment items (clearing) that result in the transfer of funds and/or adjustment of financial positions (settlement).

The new oversight framework would only apply to retail payments carried out solely in fiat currencies and not virtual currencies.

The Government of Canada’s 2019 Budget “Investing in the Middle Class” included plans to legislate first measures of a new retail
payment oversight framework, drawn from the Department of Finance's 2017 consultation paper discussed above. These commitments to legislate include end-use fund safeguarding and operational standard requirements, however new legislation has not yet been published to introduce the aforementioned measures.

PAYMENTS MODERNIZATION

Modernization is a multi-year Payments Canada initiative to modernize the systems and rules that are essential to Canada's payments ecosystem. In April 2016, Payments Canada published the initial Vision for the Canadian Payments Ecosystem (the “Vision”) and in December 2016 published an Industry Roadmap & High Level Plan which discusses how Payments Canada and the industry can modernize the Canadian payments ecosystem to advance the Vision. On December 21, 2017, Payments Canada published the Modernization Target State, which provides an in-depth view of the target end state for payment system modernization in Canada, including the infrastructure, rules and standards that will benefit Canadians and businesses from coast-to-coast.

Most recently, on December 19, 2018, Payments Canada published the Modernization Delivery Roadmap 2018 Update (the “Roadmap”). The Roadmap provides an update on Canada's progress on its payments modernization program, which includes implementing a new credit risk model for Canada's retail payment system and enhancing Automated Funds Transfer. The Roadmap provides revised timelines for the implementation of the modernization initiative.

The Roadmap discusses:

- **High-value payments system - Lynx:** The appointment of a prime vendor for hosting and system integration services as an additional step to manage risk and effectively deliver on Payments Canada's commitment to meet the highest international security, resiliency and operating standards. The prime vendor will support the end-to-end delivery and operations of Lynx, including oversight of SIA, the application provider for Lynx.

- **Real-time rail:** Clearer articulation of the release schedule for the new real-time payments system in Canada. The first release (referred to as R1) of Canada's new real-time payments system is a foundational release that will deliver the real-time processing of transactions, real-time deposit and real-time availability of funds. R1 will include an enhanced risk model using collateral pledged through the Bank of Canada to support final and irrevocable real-time payments, which will lower settlement risk and support broadening access to new participants; an alias management capability that allows for the routing of payments using an email address or mobile phone number; the capability to carry additional payment information based on ISO 20022 message standards; and the availability of standardized APIs. Future releases of Canada's new real-time payments rail will build on this foundation, creating opportunities for innovation and competition in the Canadian marketplace.

- **Retail batch payments:** The prioritization of additional improvements to the current retail batch payments system in advance of progressing to a new, centralized system, which will reduce system risk and support broadening access to members. The additional enhancements to the current system will build on the series of enhancements introduced in 2018. In 2018, modifications were implemented to the existing retail batch payments system, the Automated Clearing and Settlement System (ACSS), that allow Canadian businesses to move funds more frequently and make same day settlements. The delivery date of an enhanced centralized retail batch system has been extended beyond the R1 launch of the Real-Time Rail (RTR) and Lynx. Focus has shifted to the delivery of regulatory enhancements that will reduce system risk including increasing collateral coverage and implementing value caps on individual transactions.

Please see below the Roadmap providing revised timelines for Lynx, the real-time rail and the retail batch payment system.
PEER-TO-PEER LENDERS

The scope of regulation and legislation applicable to peer-to-peer (P2P) lenders will depend on the specific nature of the operations; however, P2P lending platforms will typically fund loans or portion of loans and operators of such a platform and will need to be aware of, among other things, Canadian securities law requirements (including prospectus and registration requirements as well as available exemptions) and applicable money laundering, criminal activity and terrorist financing legislation such as the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA).

Regulation of payment services

See Electronic payment platforms above.

Application of data protection and consumer laws

In Canada, the federal Personal Information Protection and Electronic Documents Act (PIPEDA) governs the way private sector organizations may collect, use and disclose personal information in the course of commercial activity. Where provincial privacy legislation governing the private sector's collection, use and disclosure of personal information has been deemed as ‘substantially similar’ to PIPEDA, the provincial legislation will apply instead. Alberta, British Columbia and Quebec each have provincial legislation that supersedes PIPEDA in regulating personal information collection, use and disclosure in the private sector.

Canada's federal Bank Act also contains provisions regulating the use and disclosure of personal financial information by FRFIs.

Money laundering regulations

The PCMLTFA gives the Financial Transactions and Reports Analyst Centre of Canada (FINTRAC) responsibility for supervising anti-money laundering controls of businesses in Canada that engage in foreign exchange dealing, remittance or transmission of funds, securities dealing, portfolio management and investment advice.

Pursuant to PCMLTFA, businesses are required to verify their clients’ identities, maintain certain records, and report suspicious
transactions to FINTRAC.

On July 10, 2019, Canada's Department of Finance published amendments to the regulations made under the PCMLTFA which are set to come into force on June 1, 2020 and 2021. Among these regulations is an expanded definition of money services businesses to include domestic and foreign business that are dealing in virtual currency (see What is a Cryptocurrency? above). Accordingly, person and entities dealing in virtual currencies will soon be subject to similar obligations as other reporting entities.

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake or some other form of interest such as a convertible note. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital (VC) providers, which permits the founder to pursue the growth of the business as the founder and its advisors envision.

CROWDFUNDING

The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform. Crowdfunding activities in Canada are typically subject to applicable securities laws (including in respect of the platform as well as the equity security being offered).

There are two three main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares or other securities being issued in exchange for investment in the company.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access; however, crowdfunding has not had significant success and adoption as a means to finance startup businesses in Canada, with most FinTech startups pursuing the other methods of financing referred to below.

ACCELERATORS

There are various early-stage business incubators and accelerators in the Canadian market which offer support, facilities and funding for startups, often in return for an equity stake.

Venture capital and debt

VC funding is a type of equity investment usually targeted at early stage FinTech companies. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a funding division of a corporation. The benefit of having a CVC as an investor for a FinTech startup is that, among other things, the investor is able to share its sector knowledge and expertise with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a fixed term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company at a discounted price upon certain events or otherwise. There are also other financing alternatives that may be put in place with venture investors or lenders such as a simple agreement for future equity. The merits of these structures should be discussed with your legal and financial advisors.
Senior bank debt and capital markets funding

SENIOR BANK DEBT

Typically, once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Canada has both debt and equity capital markets which are accessible to businesses of varying sizes. For example, a FinTech company may elect to become a reporting issuer in one or more of the provinces and territories of Canada through an initial public offering of its securities (IPO). In Canada, an IPO involves the issuance and sale of securities of the company and a concurrent listing on a stock exchange. An IPO may be completed in different ways, including by way of a reverse take-over of an existing public company.

CONVERTIBLE BONDS/LOAN NOTES

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances (for example, upon the completion of an IPO or the raise of a certain amount of investment).

Incentives and reliefs

The Canadian provinces and territories as well as the federal government, offer various tax credits, tax benefits and other incentives. These include the Scientific Research and Experimental Development Tax Incentive Program (SRED) or research and development (R&D) tax credit, to provide qualified Canadian companies with funds to undertake capital expenditures to reduce costs and generate marketing dollars to promote commercialization efforts. Depending on where in Canada the FinTech business is established and/or operates, certain other credits and incentives may be available, such as e-commerce credits and technology and innovation credits. In addition to various incentives and reliefs that may be available, the Federal Government also supports certain venture funds with FinTech companies as desired investments and there are government funds designed to do the same.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are as follows.

Novation

A novation is a tripartite arrangement among the original parties to a contract and a transferee seeking to replace the transferor to the contract. It is a full legal transfer of the transferor's rights, benefits and obligations to the transferee. All parties to the original contract need to consent to the new contract and the non-transferring party must accept the new contract in full satisfaction of, and as substation for, the old contract.

Assignment
An assignment is a transfer of rights and benefits of the transferor only, not its obligations under the contract. Subject to any contractual restrictions, assignments generally can be done without the consent of the non-assigning party to the contract. The burden under the original contract remains with the assignor and, as such, the assignor can be held liable if the assignee fails to perform the obligations under the contract. An assignment does not replace the original contract and does not create a new contract.

Generally, loan transfers will be documented using the bank's standard form documentation. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

Last modified 2 Jan 2020

**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent and notification** – whether a transfer requires the consent or notification of any other parties.

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**Projects**

**Financing / investing in energy / infrastructure**

**To what extent are energy and infrastructure assets publicly or privately owned?**

**Generally**

The ownership of energy and infrastructure assets in Canada varies according to the asset class.

The main asset classes include:

- energy, including both electricity and gas distribution, as well as oil and gas production;
- public transit;
- trade and transportation, including roads and bridges;
- telecommunications;
- municipal, including water and wastewater and waste disposal; and
- social infrastructure, including education, health and justice/prisons, housing.

Key sectors are considered below.

**Energy**

The ownership of gas and electricity supply utilities varies significantly from province to province and in some cases from asset class to...
asset class. Long distance pipeline and gas transmission infrastructure crosses provincial and national boundaries and is privately owned. Gas distribution networks within provinces are generally also privately owned, with a small group of established utilities dominating the market.

In the electricity sector, each province has its own transmission grid, with a somewhat modest level of ‘east-west’ intertie capacity between provinces and, in some provinces, with significant ‘north-south’ intertie capacity with US systems. Provincial transmission systems are either owned by private entities and/or by publicly-controlled Crown corporations. For example, Alberta's transmission system is owned by several large private utilities. The majority of Ontario's transmission system is owned by Hydro One, which was historically a 100% provincially owned Crown corporation, but now privatized (Hydro One had an initial public offering in 2015. The Province of Ontario directly owns 47.4% of the shares of Hydro One. The remaining 52.6% of its shares now trade publicly (although provincially-owned Ontario Power Generation holds about 1.5%). British Columbia's transmission system is owned by BC Hydro, also a provincially owned Crown corporation.

Local distribution systems may also be privately or publicly-owned. Alberta is characterized by private and municipal ownership, whereas Ontario's distribution systems have historically been operated by municipally owned utilities or, in rural and some urban areas, by Hydro One. Generation assets may also be privately or publicly owned. Ontario offers an illustrative mix, in that some large hydro and nuclear baseload facilities are owned by a Crown corporation (Ontario Power Generation), some nuclear facilities are privately owned (e.g., Bruce Power), and most gas-fired, wind and solar facilities are privately owned. British Columbia's largest generating facilities are owned by BC Hydro, while several smaller cogeneration facilities as well as wind and hydroelectric facilities are owned by private investors. Alberta's generation fleet is owned by private investors and by municipally-owned utilities.

Oil and gas infrastructure in Canada, including both exploration and production of petroleum and gas and pipeline infrastructure, is almost entirely privately owned. While at one time the Canadian federal government and some provincial governments maintained some ownership interest in the oil and gas industry, those interests have been entirely sold off. There are many hundreds of companies in the exploration and production space, ranging in size from vertically integrated global majors to very small venture firms. There are several dozen companies active in the transmission and distribution pipeline space.

There is one significant exception to private ownership in the oil and gas space. The Trans Mountain pipeline, which carries a variety of crude oil and refined products from Edmonton to Vancouver, was purchased by the Canadian federal government in 2018 in the midst of an expansion project stalled in court challenges and regulatory delays. It is widely expected that the Trans Mountain pipeline will be privatized after the completion of the expansion project, expected in mid-2022.

The National Energy Board regulates aspects of the energy system that cross inter-provincial and international borders. For example, the NEB regulates the construction and operation of interprovincial and international oil and gas pipelines (including tolls and access), international power lines and designated interprovincial power lines, the export of oil, natural gas and electricity, and the import of electricity. Provincial regulators are responsible for similar matters which take place entirely within a province. For example, in Ontario, the Ontario Energy Board regulates electricity and gas rates, licenses generators and distributors, and grants leave to construct certain gas and electricity distribution lines, while the Independent Electricity System Operator manages the transmission grid and runs the wholesale electricity market. In Alberta, the Alberta Energy Regulator regulates oil and gas matters and the Alberta Utilities Commission regulates utility matters such as electricity transmission and distribution.

Telecoms infrastructure

Telecommunication infrastructure, including telecommunication and broadcast systems, is primarily privately owned in Canada. Three incumbent carriers (Bell, TELUS and Rogers) own the majority of the landline, wireless, and internet networks, with some smaller and regional carriers attempting to gain market share. There are a number of privately owned Canadian broadcasters, as well as the publicly owned Canadian Broadcasting Corporation (CBC).

The telecom sector is extensively regulated, including by the Canadian Radio-television and Telecommunications Commission (CRTC) and by Industry Canada (which, for example, manages wireless spectrum).

Transport infrastructure

ROAD INFRASTRUCTURE

The majority of Canadian highways are the responsibility of provincial or territorial jurisdictions and the provincial or territorial governments are primarily responsible for the planning, design, construction, operation, maintenance, rehabilitation and financing of the
road network. There are limited exceptions to this general rule. Highways which run through National Parks are the responsibility of the federal government and a small percentage of highways fall under municipal jurisdiction.

In comparison to other countries, Canada's use of tolling on its highway infrastructure is limited. The main exception to this is international bridge crossings between Canada and the US, which are tolled (although the current federal government has committed to removing tolls from the replacement Champlain Bridge International Crossing under construction in Montreal, Quebec). One example of a tolled highway is Highway 407 to the north of Toronto, Ontario, which is owned and operated by a private consortium.

While the responsibility for highway infrastructure falls to the provincial and territorial governments, the federal government does invest significantly in highway and road infrastructure through funds administered by Transport Canada and Infrastructure Canada. Federal government also owns and maintains a number of strategic bridges in Quebec and manages the Canadian portion of several international bridges.

In recent years, significant spending has been incurred in relation to road transportation infrastructure and this has encouraged the development of alternative means of procurement for such infrastructure, including public-private-partnerships dependent on private financing.

RAIL TRANSPORT

Canada has a large rail network including two major publicly-traded Class I freight railway companies, Canadian National Railway Company and Canadian Pacific Railway Company, as well as shortline railways that connect to them; and deliver traffic to and from them. Passenger rail services are provided nationwide by VIA Rail, a federal Crown Corporation. Commuter services are also provided at various locations by urban transit authorities owned or controlled by different levels of government.

Within urban municipalities, subway and light rail systems have been a particular focus of investment. LRT systems exist in a number of Canadian cities, including Toronto, Ottawa, Calgary and Edmonton.

Rail transportation is regulated at the federal level for both national and inter-provincial railways. Short line railways operating intra-provincial rail systems are generally subject to provincial regulation, although responsibility and oversight for parts of their operations are sometimes ceded by a province to federal authorities.

For subway and light rail systems that operate within municipal boundaries, the municipalities have responsibility and a number of the recent subway and LRT projects have been procured by municipal authorities albeit with significant amounts of provincial and federal funding.

Social infrastructure

Healthcare infrastructure in Canada is primarily the responsibility of the relevant province and healthcare expenditure is a significant portion of the budgets of each of the provinces across Canada. Hospitals are almost entirely public with relatively limited availability of private healthcare facilities.

Similarly, provinces are responsible for the organization, delivery and assessment of education at the elementary and secondary levels and for post-secondary education. A number of jurisdictions have procured ‘bundled’ school projects through alternative financing processes and public-private-partnerships. Most notably, Alberta has procured three sets of bundled schools through PPPs and Saskatchewan has also implemented a bundled school project.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment generally in infrastructure projects in Canada. Depending on the nature of an investment and the parties involved, a particular investment may be subject to rules of general application. For example, significant mergers may be reviewable under the federal Competition Act and acquisitions of control by foreign entities may be subject to notification and/or substantive review under the federal Investment Canada Act, which has jurisdiction to determine whether an investment by a
foreign entity is of ‘net benefit to Canada’. There is closer scrutiny where the investment by a foreign entity may raise issues of national security or where the investing entity is controlled by a foreign government (a ‘state-owned enterprise’). Projects may also be subject to a variety of types of approval ranging from environmental approvals or municipal permitting requirements.

**Energy**

There are no special rules for investing in oil and gas. As noted above, certain large investments by foreign entities may be reviewed under the Investment Canada Act or Competition Act, and investments by state-owned enterprises may attract additional scrutiny. In particular, the purchase of oil sands projects by state owned enterprises will generally be forbidden.

The electricity markets in Canada are heavily regulated. In some cases, these regulations are directly relevant to investment in electricity infrastructure. As one example, in Ontario, severe tax consequences can arise if a municipally owned distribution sells distribution assets to a private-sector entity or undergoes significant investment by a private-sector partner. These consequences have been a significant barrier to private-sector investment in the distribution sector but have recently been the subject of partial, time-limited exemptions (currently set to expire January 1, 2023) that are intended to spur consolidation in the sector.

As discussed further below, the manner in which electricity infrastructure (generation in particular) varies significantly across the country, with jurisdictions like Alberta traditionally preferring deregulated approaches based on merchant market pricing while jurisdictions like Ontario have historically run highly structured procurements that resulted in long-term power purchase agreements at fixed prices. Investors wishing to make greenfield investments in a province therefore need to acquire an intimate understanding of that province’s procurement regime. Ontario’s evolving market is an illustrative case: after running a feed-in tariff (FIT) program for many years that spurred significant private-sector investment in new renewable generation, the province has recently brought that FIT program to an end, is exploring ways to move to more market-based procurements of capacity and energy, and is even exploring options for reducing the cost of legacy power purchase agreements. While Alberta has traditionally pursued a deregulated approach to generation (requiring investors to pursue their own long-term offtake contracts), it has recently started to encourage the development of renewable energy projects by providing long term price supports for selected renewable electricity projects. Investors wishing to invest in existing projects must also review the applicable regime carefully, including for restrictions on changes of control and requirements to retain levels of community and aboriginal equity participation.

**Telecoms infrastructure**

The federal Telecommunications Act places Canadian ownership and control requirements on telecommunications common carriers. As a starting point, telecommunications common carriers must be at least 80% beneficially owned by Canadians with at least 80% of the board comprising Canadian individuals. In 2014, in response to calls to increase competition, the Canadian government introduced an exception to these requirements for carriers having less than 10% market share. Given overwhelming concentration of market share with the large incumbents, this exemption only applies to a very small number of carriers.

Canadian broadcasters are subject to similar Canadian ownership and control requirements. The voting shares and votes of the broadcaster must be 80% owned by Canadians, Canadians must comprise at least 80% of the board of directors, the CEO must be Canadian, and the broadcaster cannot be controlled in fact by non-Canadians. Some companies that have integrated telecommunications and broadcasting businesses may be subject to the requirements applicable to broadcasters even if they qualify for the exemption available to smaller telecommunications carriers.

As it currently stands, Canadian ownership and control requirements do not apply to over-the-top video (OTT) broadcasters that distribute programming only through the Internet or on mobile devices in accordance with the CRTC’s Exemption order for digital media broadcasting undertakings. Given the growth of this type of business, the applicable regulations have the potential to evolve in the coming years.

**Transport infrastructure**

For rail infrastructure, while there are rules requiring licensing and other regulatory approvals under federal legislation and regulations, in systems which are operated by municipalities or public agencies, private entities can participate through the provision of infrastructure, including rail systems and rolling stock. A wide range of private entities participate in the market for the design, construction, operation, maintenance and rehabilitation of rail systems and vehicles.

Since 2004, provinces and municipalities have increasingly looked to alternative procurement models, particularly public-private
partnerships for the procurement of rail and LRT projects.

Similarly, in road transportation there are no special rules for investing in entities which are involved in the design and construction of highways or in their maintenance and rehabilitation. Again, a number of provinces have utilized public-private partnerships as the procurement model for new highways, key road, and bridge infrastructure.

Social infrastructure

While hospitals are primarily publicly owned, they are designed, constructed and maintained by private entities and in numerous provinces, public hospitals have been the subject of public-private-partnerships and alternative forms of procurement, notably in British Columbia and Ontario.

Similarly to jurisdictions outside Canada, on infrastructure projects, whether transportation or social, which are procured by the public sector, there is regularly a ‘change in ownership’ restriction which applies in relation to the private entity or consortium carrying out the construction of a publicly procured project. This restriction on change in ownership is often, but not always, removed within a year of two of successful operation of the public facility to enable recycling of capital by entities involved in infrastructure development. This also promotes the development of an active secondary market in infrastructure assets.

What is the applicable procurement process?

Investing in infrastructure

While there is no legislative regime specifically covering the public procurement of infrastructure assets, a body of law has developed relating to the procurement of such projects by public sector organizations. The principles that underpin this jurisprudence are primarily directed at fairness and transparency on the part of the public authority in relation to bidding entities. The development of a two-stage request for qualifications/request for proposals process has emerged as a very common means of conducting such procurement. Following initial qualification, usually based on experience of similar or related projects, the public authority selects a relatively small number of bidders to proceed to the request for proposals stage. Under the relevant Canadian jurisprudence, the documentation setting out the rules of engagement for the procurement establish an offer, which is accepted and converted into a contract (Contract A) when a proponent submits a compliant bid. This is distinguished from the contract for the development of the facility or asset (Contract B), which is ultimately entered into between the authority and the proponent when it is selected as the winning bidder.

Investing in energy

The construction of new oil and gas infrastructure, such as pipelines and distribution systems, being privately owned, is not subject to public tendering or procurement processes.

There is an element of public procurement to the awarding of leases for oil and gas exploration. Most oil- and gas-producing lands in Canada are owned by the provinces, which conduct periodic sales of the right to explore for and produce petroleum from those lands. The sales are generally conducted via an open, public auction. A party wishing to purchase lands for oil and gas exploration may either participate in one of these auctions (which are generally for the sale of unexplored and unproven lands) or may purchase existing, proven oil and gas leases from existing producers.

The methods by which new electricity infrastructure is procured vary from province to province and also evolve with time.

Many transmission projects are undertaken by the incumbent utilities without a public procurement process. For example, the reinforcement of the Bruce-to-Milton line in Ontario was undertaken by Hydro One has part of its system planning. While an aboriginal group received an equity stake in the project, the opportunity was not generally open to outside equity investors. Some large transmission projects are initiated through a public procurement process open to all prospective developers, not just the regional incumbent. For example, the Alberta Electricity System Operator ran a competitive develop-design-build-finance-own-operate-maintain process for the construction of a 500km, 500kV line serving Fort McMurray.

Distribution projects tend to be undertaken by existing distribution utilities. While procurement process may be run to obtain design, construction and other services, the projects as a whole are usually managed by the utilities.

Generation projects may be, but are not universally, publicly procured. Alberta has historically taken a ‘hands off’ approach to generation,
allowing private sector developers to undertake new projects in response to wholesale pricing and other negotiated offtake agreements. However, it has recently prioritized the development of renewables - as described above, the Alberta government has provided price supports for the generation of renewable electricity from projects selected in a competitive bidding process conducted over several rounds in 2017-2019. Ontario’s approach continues to evolve. The Feed-in Tariff (FIT) program introduced in 2009 offered 20-year power purchase agreements at guaranteed rates to developers of wind, solar, hydro and biomass/gas projects. Development of grid-connected projects boomed, but that boom is now over as the Independent Electricity System Operator (at the behest of the Province of Ontario) cancelled the FIT program, terminated hundreds of FIT version 5 contracts that were pre-construction, announced a zero-tolerance policy for delays projects that are under construction, and commenced a review of the contracts of existing projects to identify cost savings opportunities. The IESO has recently shifted to a transitional capacity auction market to procure generation, but the IESO’s long-term strategy for generation procurement continues to evolve.

Financing infrastructure and energy

Financing for infrastructure and energy projects is not generally the subject of a separate public procurement process. The manner in which a particular project has been procured will, however, have a significant impact on financing terms.

What are the most common forms of funding / investing in energy and infrastructure?

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate-finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders;
- bond finance;
- hybrid financing, particularly on long term projects where the initial design and construction activities or a portion thereof are paid for through one or more progress or milestone payments. In these cases, the design and construction activities are financed by short-term construction facilities from commercial banks, whereas the long term debt is provided by way of bond financing, either underwritten or privately placed;
- mezzanine debt (in some sectors); and
- refinancing of the debt in operational projects.

Infrastructure financing

The financing of infrastructure will largely depend on the nature of the contract which is being let for the development of the relevant facility. Standard construction financing is available from commercial banks in the Canadian domestic market for design-build contracts for the construction of facilities. These are predominantly short-term facilities that are paid off through milestone or progress payments as the construction develops or through a substantial completion payment towards the end of construction.

If the procurement of the relevant facility involves operation, maintenance or rehabilitation of the facility throughout its useful life, then long-term financing is regularly utilized. Until 2008, European lenders regularly lent long-term debt into the Canadian market. Canadian commercial banks are reluctant to provide long-term tenors and so Canadian commercial bank debt is not available for long-term financing. However, with the shorter tenors being offered by European lenders after 2008, the Canadian capital markets have largely replaced long-term commercial bank debt. There are two primary forms of long-term financing used in infrastructure development. The first is the private placement of long-term debt, usually through bond or note facilities to long-term institutional investors such as life insurance companies. These debt instruments may be rated or unrated. The second predominant mode of financing for long-term debt is the broadly marketed underwritten bond, which is usually a rated product. Each of the main six Canadian banking institutions will provide underwriting for such a capital markets issuance. Bonds are usually sold down to long-term bondholders with life insurance companies again being major investors in this class of debt.

Investing
Common forms of investing in energy and other infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, including share capital, limited partnership interests, and/or subordinated shareholder/unitholder loans; and
- secondary market investment in operational projects (acquisition of ‘equity’).

Unlike other markets (in particular the US), tax equity structures are not typically employed for electricity projects as Canada does not have the same focus on tax incentives as a means of promoting these projects. Similarly, tax-exempt banks are not a feature of debt financing in the Canadian market.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

There is no single body that investigates regulatory non-compliance. Each regulatory statute generally establishes an enforcement body charged with enforcing the statute.

When the applicable regulatory authority considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch an investigation. This may result in regulatory sanctions or penalties.

What regulatory penalties may apply?

The scope of the applicable regulatory authority's powers are set out in the governing legislation. Generally, when a breach has taken place the applicable regulatory authority may impose a financial penalty or censure, or withdraw regulated status against the firm or regulated individuals.

What criminal penalties may apply?

Depending on the nature of the breach, the applicable regulatory authority may disclose cases of non-compliance to law enforcement, including, but not limited to, cases relating to:

- insider dealing;
- breaches of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Canada); and
- fraud.

Criminal penalties may include fines and/or imprisonment.

Tax

Tax issues
**Are stamp, registration, transfer or other similar taxes applicable?**

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

No stamp, registration, transfer or other similar taxes are payable on the taking, transfer or assignment of a mortgage, debenture or other security. There may be nominal registration fees required to perfect a security interest.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security.

**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Generally, secured lenders and secured debt security holders take priority over the Canada Revenue Agency on enforcement of security, provided that the Canada Revenue Agency has not previously taken steps to register itself as a secured creditor. However, the Canada Revenue Agency has a 'super priority' right over secured creditors (other than holders of a mortgage over real property) with respect to taxes collected by the debtor on behalf of the Canada Revenue Agency (including employee source deductions, non-resident withholding tax and goods and services tax (GST)). This 'super priority' does not extend to GST if the tax debtor is in a proceeding under the Bankruptcy and Insolvency Act or the Companies' Creditors Arrangement Act.

**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Canada does not impose withholding tax on interest payments under a loan from a Canadian resident lender unless the loan is part of a back-to-back loan arrangement. Generally, a back-to-back loan arrangement is one in which a third party (whether resident in Canada or not resident in Canada) is interposed between a Canadian borrower and a lender not resident in Canada in an attempt to avoid the application of withholding tax that would otherwise apply.

Canada does not impose withholding tax on interest payments under a loan from an arm's length lender not resident in Canada unless either:

- the interest is 'participating debt interest'; or
- the loan is part of a back-to-back loan arrangement (as described above).

'Participating debt interest' is defined as interest that is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of a corporation.

Canadian withholding tax generally applies to interest payments to a non-arm's length lender not resident in Canada.
If so:

What is the rate of withholding?

If applicable, the current rate of Canadian withholding tax on interest is 25%.

What are the key exemptions?

Where Canadian withholding tax does apply to interest payments, the primary exemption is under a double tax treaty (such treaty may only provide for partial exemption). For instance, under the Canada-United States tax treaty, interest paid to a non-arm's length US resident lender is exempt from Canadian withholding tax. However, under the Canada-United Kingdom tax treaty, the withholding tax rate is 10% on interest paid to a non-arm's length UK resident lender.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Marc Philibert
Partner
DLA Piper (Canada) LLP
marc.philibert@dlapiper.com
T: +1 514 392 8442
Chile

Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

In the debt market, debt securities have to be issued by institutions accredited by the CMF. In addition, the issuance is regulated by the CMF.

What are common issuing methods and types of debt securities?

The most common securities issued in Chile are:

- **subordinated bonds** – bonds issued by banks which have a lower priority for the creditor;
- **promissory notes and bonds issued by the Chilean Central Bank and the General Treasury of the Republic** – instruments issued by the two aforementioned entities, with the purpose of regulating the money supply, supporting the exchange policy, financing state projects or replacing external debt;
- **convertible bonds** – issued by corporations and SpA to finance investment projects, which are convertible into shares of the issuing company;
- **corporate bonds** – issued by corporations to finance long-term investment projects, or to comply with financial commitments of the issuer, such as the refinancing of liabilities;
- **securitized bonds** – issued by securitization companies with the objective of anticipating the flows of certain financial assets of a company or financial institution, such as mortgage or automobile loans; and
- **mortgage letters** – issued by banks or financial institutions, to finance mortgages or various productive activities.

What are the differences between offering debt securities to institutional / professional or other investors?

In most cases there are no differences in the recipient of the offer, with the exemption of the offer made to certain ‘qualified investors’, which – under compliance of certain rules – can be done privately (in opposition to the general rule which is the public offering).
When is it necessary to prepare a prospectus?

According to General Rule (Norma de Carácter General) No 30 of the CMF, the public offering of debt securities requires the submission of a prospectus (which is pre-drafted by the CMF and must be filled by the issuer). Before it can be published, the prospectus must be previously submitted before the CMF.

In case of public tender offers, the offeror must prepare a prospectus containing all the terms and conditions of the offer, and make it available to the interested parties, in the places mentioned in the Securities Law, from the date of the notice of initiation and during the validity of the public tender offer.

What are the main exchanges available?

The main exchanges are the:

- Stock Exchange (Santiago and Valparaiso);
- Electronic Exchange; and
- Products Exchange.

Please note that the Santiago Stock Exchange forms part of the Latin American Integrated Market (MILA), which is the result of the agreement signed between the Santiago Stock Exchange (Chile), the Colombian Stock Exchange, the Lima Stock Exchange (Peru) and the Mexican Stock Exchange, as well as the related central securities depositories (DCV in Chile, Deceval in Colombia, Cavali in Peru and Indeval in Mexico). This establishes a regional market for the trading of equities in the four countries, making MILA the Pacific Alliance Securities Market. MILA's mission is to integrate the securities markets of member countries and foster the growth of financial businesses for participants, offering the best alternative for investment, diversification, liquidity and financing.

Is there a private placement market?

Yes.

The CMF allows the private offering of securities in very specific cases, as stated in the General Rule (Norma de Carácter General) No 336. The regulations establish that the offering of securities shall not be considered as public (and thus, not subject to the strict regulations set forth in the Securities Act) in the following cases, when they:

- contain all the relevant and detailed information about the offer;
- are addressed to qualified investors (inversionistas calificados) according to certain rules; and
- are not published in mass media (press, TV, mass e-mails etc).

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

The issuance of debt securities is the responsibility of the issuer, as stated in the prospectus (which states explicitly the responsibility of the issuer regarding the information stated in it). Discrepancies in the information published to the public in the prospectus or other misleading information when issuing debt securities may lead to severe sanctions (even imprisonment).

Investing in debt securities
In financial terms, debt securities are not considered high risk (they are low risk securities, since they have a fixed profitability). However, it is advisable when investing in these kinds of securities, to fully revise the prospectus and check the issuer’s background and its qualifications.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Law No. 20,712 regulates the administration of third parties' funds (Law). The Law regulates mutual funds, public and private investment funds, foreign capital investment funds and foreign risk capital investment funds. Please note that there is no explicit regulation on hedge funds, which may adopt one of the aforementioned funds form, depending on its particular characteristics.

In general terms, restrictions on establishing a fund depend on the type of fund to be established.

The Law distinguishes between two types of funds that are subject to registration and supervision of the CMF, which are:

- mutual funds, which are the ones in which redemption is made in less than 10 days; and
- investment funds, distinguishing between the ones (x) in which redemption is available in less than 180 days, or (y) in which there is no redemption available (fondos de inversión no rescatables).

A separate category of funds which are not subject to registration nor supervision of the CMF is private investment funds, which are required to have less than 50 investors.

The above-mentioned distinction between mutual and investment funds, which is based on how the investment is redeemed, follows the traditional distinction between closed-end and open-end funds in the US. Since both mutual funds and investment funds (other than private investment funds) are subject to registration with the CMF, they can be also listed on the local stock exchanges or traded over-the-counter in a secondary market.

Additionally, please note that there are some restrictions regarding investments, which refer to minimum conditions of information, regulation and supervision of such investments. Such restrictions are not applicable to funds for qualified investors, as long as such exemption is expressly set forth in the fund’s internal regulation.

What are common fund structures?

Funds in Chile are not corporations, but, in general terms, each fund is a separate pool of assets destined exclusively to be invested in securities or assets authorized by law.

The ownership of a fund is not represented by shares (as in LPs or LLCs), but by ‘quotas’ and investors are commonly referred to as ‘quota holders’.

Each fund must be managed by a separate corporation called an Administradora, or fund manager, which is registered and supervised by the CMF. The fund manager has the exclusive responsibility for a fund’s administration.

Please note that the fund manager is quite different from a general partner, as it only manages but usually does not own any quotas of the fund.

Fund managers must be incorporated as stock corporations (Sociedad Anónima), which, except for private investment fund managers, should be registered and subject to the supervision of the CMF. Private investment funds are managed by special purpose stock corporations which must only be registered with the CMF in a special registry of reporting entities.

As explained, common types of fund structures other than private investment funds include mutual funds, public investment funds, foreign capital investment funds and foreign risk capital investment funds. Hedge funds are not explicitly regulated, and may adopt one of the aforementioned structures depending on its particular characteristics.
Each fund structure has its own restrictions and limits, but they are all subject to registration and supervision by the CMF. In general terms, they differ on the rules applicable to redemption of the investment and permitted investments. They can all be listed on the local stock exchanges or traded OTC in secondary markets. All of the above funds must be managed by a Fund Manager.

**What are the differences between offering fund securities to professional / institutional or other investors?**

As previously explained, the difference lies not in the type of investor, but in the type of fund. Private investment funds are non-regulated funds that may not make public offering of their quotas. As a consequence, they are far more flexible than regulated investment funds, which conversely are entitled to make public offering of their quotas.

**Are there any other notable risks or issues around establishing and investing in funds?**

Fund management is a regulated and supervised activity and therefore subject to reporting requirements, depending on the type of fund managed.

**Managing and marketing debt / hedge funds**

**Are there any restrictions on marketing a fund?**

Marketing restrictions depend on the type of fund. Private investment funds may not make public offering of their quotas. Mutual and regulated investment funds are entitled to make public offering of their quotas.

Please note that funds’ ownership (funds in Chile are not corporations, but a pool of assets) are not represented by shares (as in LPs or LLCs), but by quotas instead. That is why investors are commonly referred to as ‘quota holders’.

**Are there any restrictions on managing a fund?**

Restrictions depend on the type of fund to be managed, and refer in basic terms to the type of entity the Fund Manager is required to be, and the registration and reporting requirements imposed over such Fund Managers.

**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

Non-regulated companies (limited liability companies or corporations) may freely enter into derivative transactions, including for speculative purposes, solely with any limitations under their by-laws.

Certain special entities (banks, pension fund administrators, mutual funds administrators, brokers etc) can only enter into certain derivatives transactions, which are determined by the relevant regulator. For example, the so-called Securities Agents (*Agente de Valores*) can only act as securities intermediaries regarding forward agreements over foreign currencies and indexation units and swaps agreements over interest rates, according to the rulings of the CMF.

Moreover, Chapter IX of the Compendium of Foreign Exchange Regulations enacted by the Chilean Central Bank regulates derivative
transactions that involve foreign currency flows from Chile to abroad or vice versa, which consist of futures, forwards, swaps or options agreements, credit derivatives or combinations of the same. The main obligations are:

- reporting certain information to the Central Bank of Chile; and
- that both the remittance of foreign currency abroad as well as its return to Chile must be performed through the Formal Foreign Exchange Market.

The general rule is that set-off rights in Chile do not apply in case of bankruptcy, unless the obligations arise from a derivatives agreement. Please note that the Chilean Central Bank establishes certain requisites and conditions that the derivatives agreements must contain in order that the set-off may apply.

**What are common types of derivatives?**

The most common derivatives in Chile are futures and forward agreements. There are also option agreements and swap agreements.

The main classes of underlying assets are (depending on the type of entity that enters into the specific derivative transaction):

- local currencies;
- goods, commodities and instruments representing such assets;
- interest rates;
- stock index and other indexes;
- foreign currencies; and
- indexation units (such as Unidad de Fomento).

**Are there any other notable risks or issues around entering into derivatives contracts?**

As a regulated entity, there are many risks regarding compliance with the regulation thereof (the CMF have issued a high amount of regulations regarding which derivatives they can enter into, with whom they can deal with and which underlying assets are acceptable). Therefore, regulated entities (banks, pension fund administrators, mutual funds administrators, brokers etc) must comply with this strict regulation if they do not want to be sanctioned by the CMF.

**Debt finance**

**Lending and borrowing**

**Are there any restrictions on lending and borrowing?**

Banks shall not grant credits, directly or indirectly, to one person or legal entity, for an amount that exceeds 10% of its capital; or grant credits, to one person or legal entity involved directly or indirectly to the property or administration of the bank in more favorable terms (eg interest or guarantees); or grant, directly or indirectly credit with the purpose to of habilitate a person in order to pay the bank with shares of its own issuance; or grant, directly or indirectly, credit to a director, or any other person that performs as general lawyer; and shall not become liable for obligations of third parties, but in the cases expressly stated in the law. In addition, banks are not authorized to grant mortgages or pledges over physical assets, unless these agreements are granted in order to guarantee payment of the purchase price of such assets.

In addition, suppliers of services and financial products have several obligations regarding information and marketing such as in respect
of their quotes, which shall last at least 7 business days; and reporting rates, charges, commissions, costs tariffs, conditions and term of the products offered, among others.

Borrowing is not generally regulated; however, they have the benefit granted by the National Consumers Service in order to, for example, not be tied with different products or services not requested by a financial institution.

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**What are common lending structures?**

Lending in Chile can be structured in several ways depending on the commercial needs of the parties and the features of the project being financed. Common structures used in Chile are the term loan and the revolving loan.

**Loan durations**

The terms of the loans generally depend on the features of the corresponding transaction and the policy of each financial institution. However, over five years is considered a long term.

**Loan security**

Regarding project financing, usually the bank will secure lending obligations with several types of securities (i) over assets (pledge and mortgage agreements), (ii) personal guarantees such as sureties and joint and several guarantees and (iii) conditional assignment of rights regarding the main agreements of the relevant project. Please note that in Chile guarantees are accessory to the main obligation and may not exceed the amount of such obligation.

**Loan commitment**

May be committed or uncommitted.

**Loan repayment**

Can be repaid on demand, on an amortization basis, scheduled, or even by means of a bullet loan, where the entire loan is due at the end of the loan term.

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight and less burdensome from a compliance perspective not being applicable consumer protection rights.

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**Do the laws recognize the principles of agency and trusts?**

Yes, Chilean framework recognizes the appointment of a collateral agent.

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**Are there any other notable risks or issues around lending?**

Generally

Loan agreements and other finance documents are subject to general contractual principles.
Specific types of lending

MORTGAGE LOANS

Typically, each financial institution states its conditions and performs an assessment of the debtor. The conditions usually include, for example, the amount and regularity of the income of the debtor, their age, number of dependents, and financial background. Usually the loan also involves insurance taken in favor of the debtor (fire and for surviving dependents). If a financial institution includes any abusive clause within the loan agreement, and such clause affects the consumer, a claim may be submitted before the National Consumer Service.

Standard form documentation

Most of the financial transactions standard templates are prepared by banks in-house.

Are there any other notable risks or issues around borrowing?

Normally banks perform a sound assessment of the borrower, requiring its financial background or assets they owned that may be used as security.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Yes.

According to the Chilean Civil Code, the agents acting on behalf of an entity shall act within the limits of its mandate. If the agent acts without sufficient power of attorney the principal shall not be obliged toward third parties by acts or agreements entered into by agent.

In addition, corporate authorizations in some cases are needed. For example, in order to guarantee third party obligations, and if the guaranteed obligation exceeds 50% of the corporation’s assets, an extraordinary shareholders’ meeting must be held to approve the transaction. However, if the company is a subsidiary, board of director approval is sufficient.

What are common types of guarantees and security?

The Chilean framework establishes ‘guarantees over assets’ (which is a type of security arrangement) and ‘personal guarantees’.

Common forms of guarantees

In Chile, there are different kinds of guarantees; however, both performance or payment guarantees are widely used. These are generally known as ‘personal guarantees.’ The personal guarantees regularly used are the fianzas (sureties) and fianza y codeudas solidarias (joint and several guarantees).

Through the fianzas one or more parties are obliged to pay the obligations of the debtor in the event that the latter does not pay the secured obligation. The fianza y codeuda solidaria, in turn, the liability for non-compliance is applicable directly against all debtors and guarantors as a group or against any of them individually at the creditor’s choice.

Common forms of securities

Guarantees over assets may be divided between two groups. They are guarantees over moveable assets and over real estate.

The guarantee over moveable assets is performed through pledge agreements such as:
• civil pledge, which applies to any movable property, including all kind of personal rights and credits;

• commercial pledge, which secures merchant or commercial nature obligations;

• banking pledge over moveable assets over instruments of any kind, credit payable to the order and shares in favor of banks; and

• pledge without conveyance over any kind of corporeal or incorporeal, present or future, moveable asset to secure own or third party obligations, present or future.

Regarding guarantees over real estate, they are granted by means of mortgage agreements, by which it is possible to secure not only existing and determined obligations but also to secure all present and future obligations of the debtor (**cláusula de garantía general**). Mortgages also can be granted over mining concessions and water rights.

In addition, the parties can agree a conditional assignment of rights which is a mechanism to safeguard creditors’ rights, for example, in connection to the main agreements in a project (such as EPC and O&M). If a debtor fails to fulfill its obligation under the financing documents, the creditor would be entitled to exercise step in rights regarding the project agreements.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

Consideration for guarantees is subject to general contractual principles.

Giving or taking security

In the case of some securities, such as pledges, there is a requirement for such securities to be executed by way of a public deed before a Chilean notary public and to be registered in different registries, for example:

• Pledge Over Money and Permitted Investments in the Registration in the Registry of Pledges Without Conveyance (**Registro de Prendas sin Desplazamiento**) kept by the Civil Registry and Identification Service (**Servicio de Registro Civil e Identificación**); and

• Pledge over Equipment Registration in the Registry of Pledges Without Conveyance (**Registro de Prendas sin Desplazamiento**) kept by the Civil Registry and Identification Service (**Servicio de Registro Civil e Identificación**); and to the extent applicable, registration in the **Registro de Vehículos Motorizados** (Vehicle Registrar) kept by the Civil Registry and Identification Service (**Servicio de Registro Civil e Identificación**).

In the case of mortgage agreements, they must be executed by means of a public deed between the owner of the asset and the mortgagee. Later, an abstract of such public deed needs to be registered in the relevant Mortgage Lien Registry and in the Prohibition Registry of the correspondent Real Estate Registry.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Decree with Force of Law No 1, Chilean Civil Code (2000) (**Fija texto refundido, coordinado y sistematizado del Código Civil**)
Chilean Commerce Code (1865) (Código de Comercio) (regulates commercial obligations and commercial contracts in general)

Law No 18,010, Establishes rules for credit operations (1981) (Establece normas para las operaciones de crédito y otras obligaciones de dinero) (establishes rules for credit operations and other monetary obligations)

Decree with Force of Law No 3, General Banking Act (1997) (Fija texto refundido, sistematizado y coordinado de la Ley General de Bancos) (regulation of banking activity and financial institutions and establishes the Financial Market Commission (CMF) (formerly known as Superintendence of Securities and Insurance /"SVS").

Law No 20,848, Establishes the framework for the Direct Foreign Investment in Chile (2015) (Establece marco para la inversión extranjera directa en Chile y crea la institucionalidad respectiva)

### Consumer credit

Law No 20,555, establishes protection of rights of consumers, in order to grant financial powers to the National Consumer Service (SERNAC) (2012) (Modifica Ley N° 19.496, sobre protección de los derechos de los consumidores, para dotar de atribuciones en materias financieras, entre otras, al Servicio Nacional del Consumidor) (establishes protection of rights of consumers, in order to grant financial powers to the National Consumer Service)

### Mortgages

Law No 20,855, Regulates the cancellation of mortgages and pledges that guarantee credits (2015) (Regula el alzamiento de hipotecas y prendas que caucionen créditos)

### Corporations

Law No 18,046, Corporations Act (1981) (Ley de Sociedades Anónimas) (establishes regulations to corporations)

Law No 18,045, Chilean Securities Act (1981) (Ley de Mercado de Valores) (regulates securities issuers, securities trading and other activities related to securities)

### Funds and platforms

Law No 20,712, Third party funds and individual portfolios (2014) (Administración de fondos de terceros y carteras individuales)

Law No 6,640, Establishes the Chilean Economic Development Agency (CORFO) (1941) (Texto refundida, creación de las corporaciones de reconstrucción y auxilio y de fomento a la producción)

Decree Law No 211, Establishes the regulation for the Chilean Development Agency (1960) (fija normas porque se regirá la Corporación de Fomento de la Producción)

### Other key market legislation

Chapter XIV of the Compendium of Foreign Exchange Regulation of the Chilean Central Bank (Capítulo XIV del Compendio de Normas de Cambios Internacionales del Banco Central de Chile, sobre Normas aplicables a los créditos, depósitos, inversiones y aportes de capital provenientes del exterior) (rules applicable to credits, deposits, investments and capital contributions from abroad)


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### Regulatory authorization

**Who are the regulators?**
The Financial Market Commission (CMF) (formerly known as Superintendence of Securities and Insurance ("SVS")) is in charge of the supervision of the banking enterprises, irrespective of their nature, and the financial entities whose control is not otherwise entrusted by the laws of a different institution. The CMF is also in charge of the supervision of the companies whose corporate purpose consists of the issuance or operation of credit cards or any other similar system, provided the said system considers that the issuer or operator ordinarily assumes monetary obligations to the public or certain sectors or specific groups thereof. Furthermore, the CMF has the main objective of ensuring the transparency of the markets by monitoring and publishing the public information it maintains and collaborating in the knowledge and education of investors, insured persons and the public in general.

The Financial Market Commission, was created by Law No. 21,000, published in the Official Gazette on 23 February 2017, constituting the collegial and technical institution which replaced the SVS.

Additionally, since June 1, 2019, the Superintendence of Banks and Financial Institutions ("SBIF") was integrated to the CMF. The main effect of the integration was that the SBIF ceased to exist and the CMF assumed all the faculties and responsibilities of the SBIF.

The National Consumers Service (SERNAC), strengthens the rights of consumers of financial products and services, and imposes obligations on companies of this sector.

The Chilean Central Bank looks after the stability of the currency, that is, to keep inflation low and stable over time. The Chilean Central Bank must also promote the stability and efficacy of the financial system and the normal functioning of internal and external payment systems, to generate a predictable environment for decision making of economic agents contributing to reduce the ups and downs of the economic cycles, thus providing a solid basis for the country’s permanent growth.

The Fuel and Electricity Superintendence (SEC) is a supervisory body that, among other things, is in charge of monitoring and supervising the compliance of legal and regulatory dispositions as well as technical norms on generation, production, storage, and distribution of liquid fuel, gas and electricity, as well as the administrative interpretation of the norms in the electrical sector. The SEC’s duties include ensuring the correct operation of the electricity, gas and fuel services in terms of safety, quality and price.

The Agency of Promotion of Foreign Investment is the authority in charge of qualifying and granting the certificate of ‘foreign investor’ under the Direct Foreign Investment in Chile Law.

What are the authorization requirements and process?

Banks

The legal entity shall be constituted as a stock corporation and shall comply with its requirements by submitting a prospect before the CMF according to the regulation, particularly the General Banking Act, and complying with the rules about minimum amount of capital, number of shares and number of directors, among others. The CMF must authorize by resolution the existence and functioning of the corporation. The CMF shall authorize the establishment of a foreign bank’s representative office in Chile, in order to act as agents of the main offices.

Securities

The public offering of securities and shares of publicly traded corporations require that both the issuer and the securities have been previously registered in the Securities Registry of the CMF.

The intermediaries of securities that operate in the Stock Exchange has to be registered in the Stock Brokerage Registry and Securities Agents that is held by the CMF once they meet the requisites of suitability established in the Securities Act.

Funds

In order to manage a fund (mutual or investment fund) you should be incorporated as a corporation whose exclusive purpose must be managing third party funds. An authorization from the CMF shall be obtained and minimum amount of capital must be maintained.

What are the main ongoing compliance requirements?
The regulated entities are under ongoing compliance requirements. They must maintain the thresholds that allow them to operate and they also have to continuously submit certain information to the CMF. For example, the regulated entities shall inform any amendments to their by-laws within a short time of them becoming effective.

In addition, in the case of the banks, they must maintain minimum reserves of cash that are to be determined by the Chilean Central Bank.

**What are the penalties for failure to be authorized?**

The persons or legal entities engaging in banking activities, such as accepting deposit in a customary manner from the public or as broker, commits a criminal offence and is liable to imprisonment (from 541 days up to five years) and can also face charges as author of fraud.

Regarding the registry of securities, any person or legal entity that fails to obtain the proper authorization is liable and obliged to compensate damages due to the breach and shall be subject to administrative and criminal sanctions (imprisonment). In addition, in case of misleading information submitted before the CMF, criminal sanctions such as imprisonment may apply.

**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

- Accepting deposits in a customary manner from the public
- Acting as a principal or on behalf of a third party in the brokerage of money or loans represented by securities or any other credit titles
- Exhibiting in store or offices signs of advertisement containing any expressions indicating to be a financial company
- Public offer of securities
- Management of third party funds and individual portfolios.

**Consumer credit**

Regarding granting consumer credits, such activities are only regulated in connection to interest rates (they do not require special authorization).

**Are there any possible exemptions?**

Even though it is a regulated activity, there are exceptions such as non-banking factorings whose focus is to provide capital to small- and medium-sized enterprises.

**Do any exchange controls or other restrictions on payments apply?**

**Direct foreign investment**

The transfer of foreign capital or assets owned or controlled by a foreign investor into Chile, for a sum equal to or greater than US$5 million or its equivalent in (i) other currencies, (ii) physical goods in all its forms or states, (iii) profit reinvestments, (iv) capitalization of
credits, (v) technology in its various forms that is susceptible to be capitalized, or (vi) credits associated with foreign investment from related companies.

In addition, the above-mentioned is applicable to all investments that are conducted through the purchase of shares in the capital of a Chilean company, in which the foreign investor acquires at least 10% of the voting shares of said company, whether directly or indirectly.

Chapter XIV of the foreign exchange regulations of the Central Bank of Chile

It regulates all foreign loans, deposits, investments and capital contributions from abroad and others referred to foreign obligations, for an aggregate amount higher than US$10,000. These rules are not applicable to transactions of this nature performed by banks.

All transfer of funds into Chile from abroad as loans, deposits and investment or capital contributions, shall be made through the Chilean Formal Foreign Exchange Market (MCF) and shall be informed by commercial banks to the Chilean Central Bank by means of a standard form. However, according to the regulations currently in force, no access to the MCF is guaranteed to the foreign investor or capital contributor and the Chilean borrower, as applicable, for the repatriation of the capital investment and/or profits, or the payment of the principal and/or interest of the foreign loan, respectively.

Notwithstanding the information included in the above-mentioned standard form, any party to an international credit transaction equal to or higher than US$1 million or its equivalent in a different currency, shall inform the Chilean Central Bank in writing about the execution of such transaction.

What are the rules around financial promotions?

The National Consumers Service (SERNAC) grants certificates in respect of those contracts that it has reviewed and verified that comply with the Consumer Protection Law and regulations (which for example, require that such contracts do not contain any clause that may be abusive). The suppliers that promote or distribute financial pre-formulated standard agreement or financial services without the SERNAC certificate as they had it, shall be sanctioned up to US$70,000. In case of a second offence, the fine could be up to US$140,000.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

For the purposes of banking activities and managing funds the legal entity shall be incorporated as a corporation.

Regarding private investment, in the vast majority of cases, the form of organization can be freely chosen, with the exception of specifically regulated business areas such as insurance companies or some utilities providers, who are required to follow a specified legal structure.

For example, in Chile it is common to use the following vehicles.

CORPORATIONS

Corporations in Chile can vary in nature, and because of this, are regulated accordingly. The main difference exists between corporations being publicly or closely held.

PARTNERSHIP LIMITED BY SHARES (SPA)

SpAs are a special type of corporation with a basic structure resembling a closely held corporation. The SpA structure is more flexible and has fewer formalities as well as less economic and administrative costs.
LIMITED LIABILITY COMPANIES

Limited Liability Companies follow generally the structure of a partnership, with the main difference that the liability of the owners of a Limited Liability Company is restricted to the capital amounts subscribed by its partners.

Is it possible to conduct lending or investment business through a branch or establishment?

Foreign companies can also act in Chile through a branch or agency, which is to be considered as the foreigner itself and not as a different entity, so as a consequence, rights and/or obligations of the branch in Chile are deemed to be rights and obligations of the foreign entity.

Foreign banks operating in Chile will enjoy the same rights that national banks of equal category and will be subject in general to same laws and regulations, unless it is provided otherwise.

Pursuant to the General Banking Law, the CMF may authorize foreign banks to maintain representations that act as business agents of their parent companies and will have over them the same inspection powers that such law confers on the banking companies.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

Marketplace lending in the form of FinTech initiatives such as peer-to-peer (P2P) platforms is in its early stages of development in the Chilean market. Some examples of FinTech applications and products which are currently operating in Chile are as follows:

- Broota is in an equity-based crowdfunding platform, and a leader in the finance and investment marketplace in Chile.
- ConsenSys is a venture production studio which builds decentralized applications and end-user tools for blockchain ecosystems,
primarily focused on ethereum. ConsenSys coordinates, incubates, accelerates and spawns ventures by helping venture enterprises to develop, including by way of resource sharing, investing in ventures themselves, and acquiring them outright and through the formation of joint ventures.

- Godzillion is an entity which is currently operating on blockchain. Through the Godzillion platform people can vote, fund, and trade startups without limitations.

**Blockchain, smart contracts and cryptocurrencies**

**WHAT IS BLOCKCHAIN?**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**WHAT IS A CRYPTOCURRENCY?**

While there is no official definition of a cryptocurrency, in the global market it is understood that cryptocurrency is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large, developing infrastructure for holding, pricing and exchanging currency).

**EXAMPLES IN THE CHILEAN MARKETPLACE**

On May 2018, the Ministry of Treasury indicated that the market capitalization of the cryptocurrency in Chile is around US$400.000 million. Some examples of cryptocurrency-based platforms which operate in Chile include SurBTC and TradeBTC. CryptoMKT is another example of a marketplace service provider which is based on the cryptocurrency ethereum. On May 2017, the Santiago stock exchange (Bolsa de Comercio de Santiago) announced that it is developing a private hyperledger using blockchain technology with IBM, which is a great indication of the level of interest and enthusiasm there is for this type of technology in Chile.

**Initial coin offerings and token-based products**
WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

We have seen the first example of an ICO launch in Chile on 23 August 2017 by a FinTech company called Godzillion. The Godzillion ICO is projected to create 300 million Godzillion tokens, known as GODZ, based on ethereum.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Although we have no substantial information about AI and robo advisory systems being used in Chile by corporate companies, banks and financial institutions have been known to use this kind of technology in their internal risk-assessment systems. In Chile, public and private universities have played a very substantial role in the study of AI which continues to be a developing technology. The only known example of locally developed tested AI is AIRA, an AI software which is used for the recruitment and selection of personnel worldwide.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Data managing cloud based systems, such as Cloudera and data analysis software such as SAS are used in Chile particularly in the banking and retail sectors and to assist with public sector projects.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

Most of the regulatory regime for banking and financial services in Chile is established through the General Banking Law, and the regulatory rules of the Chilean Central Bank and the CMF, which prevents non-banking institutions from performing banking activities.

Electronic payments platforms and regulation of peer-to-peer lenders
In Chile there are two well-established electronic payments platforms: Transbank (which is controlled by banks) and Multicaja (which is owned by a private company). There have been several attempts from other non-banking entities to provide similar services, but large financial institutions have been reluctant to partner up with them, making it a difficult area of the market for smaller market players to penetrate.

Banks have further challenged non-banking entities which were providing electronic payment services which they argued constituted performing placement operations, an activity which can only be carried out by regulated banks; however, this claim did not succeed in trial and non-banking entities were permitted to continue providing such services.

**Regulation of payment services**

In Chile, low cost payment systems, or retail payment systems, are used to carry out transactions among individuals and/or companies. This kind of payment can be made through a variety of methods such as cash, checks, credit and debit card and electronic transfers. Currently in Chile, only certain institutions are allowed to issue this means of payment; however, a new law which allows the issuance and operation of different means of payment by non-banking entities was enacted in October 2016.

Payment services transactions are regulated mainly by the SBIF, which has established a series of technical criteria to ensure that all payment services are reliable and secure.

**Application of data protection and consumer laws**

Data protection and consumer laws apply equally to FinTech operations. Furthermore, there are specific laws that regulate terms and conditions of consumer loans and financial contracts with consumers (Law No 20,555). There is also a non-privacy and security regulation which is specific to banks, established in article 154 of General Law of Banks. The regulation aims to maintain the confidentiality of the transactions that individuals perform with and through the banks, by classifying them into the following two categories:

- operations covered by secrecy, meaning that they are private and it is therefore not possible to make them known; and
- operations covered by reserve, which imposes a significant limitation on the reporting of such transactions.

**Money laundering regulations**

The Finance Analysis Unit (UAF) is the dedicated public entity whose purpose it is to prevent the use of the financial systems to commit crimes such as money laundering and financing of terrorism. The UAF is aimed at controlling certain subjects related to financial activities and establishing a series of information obligations, such as:

- keeping registries;
- declaring corporate legal changes;
- reporting cash transactions and transactions that exceed the US$10,000 limit;
- reporting of suspicious activities;
- due diligence and knowledge of their clients (know your customer (KYC));
- keeping records for at least five years;
- training employees; and
- appointing a compliance officer.

The SBIF has also established a series of rules with similar aims.

_Last modified 6 Dec 2019_

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**
SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

There are several entities that provide funding for technology in Chile, the most important ones are:

- **Corporación de Fomento de la Producción de Chile** (Production Development Corporation or CORFO) acts through its startup-oriented programs, such as:
  - **Capital Semilla** (seed money) – for innovative businesses which can reach sales for amounts above US$1 million in three years and have the ability to grow afterwards;
  - **Semilla de Asignación Flexible** (flexible seed money assignment);
  - **Start-Up Chile** (a Chilean accelerator); and
  - **Sercotec** (Servicio de Cooperación Técnica).

- **Comisión Nacional de Investigación Científica y Tecnológica** (National Commission for Scientific and Technological Research or CONICYT) acts through their technology incentives, such as:
  - **FONDEQUIP** (technologic and scientific fund);
  - **EXPLORA** (national program for science and technology);
  - **REGIONAL** (regional program for scientific and technological research); and
  - **FONDEF** (promotion fund to scientific and technological fund).

- There are also several angel investment networks operating in Chile. The Angel Investors program is assisted by **Innovachile** (a CORFO agency in charge of providing Chilean enterprises access to technology).

Venture capital and debt

CORFO provides funding through its venture capital programs, such as:

- **Programa de Aceleración de Emprendimientos en Sectores Estratégicos** (which supports business incubators and accelerators that execute programs with technological ventures associated to strategic industries); and

- **Scale Up Expansión** (for innovative ventures with growth potential).

Several private funds provide financing for these kinds of undertakings.

Senior bank debt and capital markets funding

CORFO also funds the Early Stages Funds (FET), which provide credit lines to investment funds investing in technology industries. One such example is the **Fondo Etapas Tempranas Tecnológicas Perfil Administradoras**, which promotes the development of risk capital investment funds, focusing on Chilean enterprises in their early stages of development and present a growth potential in technology-related industries.

Standard bank arrangements can also be negotiated for this kind of funding.

Incentives and reliefs

The following are examples of laws designed to help small, early-stage companies:

- The Research and Development Law, Law No 20,241 (I+D Law) aims to contribute to improve the competitive capacity of the Chilean corporations, establishing a tax incentive for I+D investment, which allows qualifying entities to reduce first category taxes of 35% of the resources that were allocated towards research and development activities.
Portfolio sales

Loan transfers and portfolio sales

*What are common ways of buying and selling loans?*

Due to the fact that loans are agreements (contracts) there are only a few legal ways to transfer (buy or sell) them.

In Chile, the transfer of loans can be conducted mainly in two ways:

- **novation** – transfer of the legal rights and obligations of the debtor to a person that shall become the new debtor. It requires the acquiescence of the creditor; and
- **assignment** – transfer of the contract from the creditor to another person, who becomes the new creditor. It requires a contract and the transfer of the previous contract (which contains the original loan). Unless agreed otherwise, it does not require acquiescence of the debtor.

*What are the main considerations when transferring a loan and related security?*

General rules regarding the transfer of agreements must be fulfilled, so the transfer can effectively operate, otherwise, the transferor shall remain liable for the loan.

Regarding novation, please consider that a new obligation is generated; therefore, the previous existing guarantees will not be effective any more, unless expressly stated by all parties.

In addition, there are usual contractual clauses that need to be considered and addressed properly such as transfer mechanics and representations and warranties among others.

Projects

Financing / investing in energy / infrastructure

*To what extent are energy and infrastructure assets publicly or privately owned?*

Generally

Regarding infrastructure, Chile has decided to include private capital in several areas of the public infrastructure, by means of privatization processes, concessions of public works or long term agreements. The infrastructure related to the energy, sanitary industry and transport infrastructure is mainly privately owned. For example, the electric infrastructure, highways, roads, ports, airports and sanitary services are operated through concessions generally.

It is important to note, that the Ministry of Public Works can finance the construction of some works with public resources, in which case
such works belongs to the State. This system allows for the construction of that infrastructure which has social relevance but is less attractive for the private entities considering the economic returns.

The concession of public works is the main modality in Chile for contracting through a public-private association. The State makes a private entity responsible for the execution, conservation, reparation and exploitation of a public work in exchange for the right to receive incomes as agreed in the concession contract. Once the concession agreement finishes, the responsibility for the works returns to the State in order to be reassigned as appropriate.

The concession system has been implemented in Chile since the beginning of the 90s, with positive results mainly because of the respect for the rule of law duly guaranteeing the interests of all the parties involved, including third parties that are related with the parties directly involved in the concession contract.

Energy and telecoms infrastructure

In general terms, the energy and telecom market in Chile has been designed so that the investment and operation of the infrastructure can be entirely controlled by private actors, promoting economic efficiency as well as new technologies through competitive markets in all of the non-monopolistic segments, while the administration only carries out regulation, control and planning functions.

Transport infrastructure and other infrastructure

The Chilean Ministry of Public Works (MOP) has a set of rules and regulations that regulate the procedures for the participation of private actors – national or foreign in the construction and maintenance of public roadworks. Such works can be financed directly by the MOP (Decree N° 75/2004) or can be built by means of private resources through the public-private alliance that represents the concession system. This set of rules and regulations constitutes a harmonious whole, under the principles of transparency and efficiency of the public resources involved.

The concession system regulated by the Public Works Concession Law applies to public works that are the direct competence of the MOP or by means of delegation. Article 39 of the Public Works Concession Law establishes that ‘The Public Work Ministry is competent to give in concession every public work, the equipment provision or the associate services provision, except in the case where those works are delivered to the competence of another Ministry, public service, municipality or public company or other organism that integrates the State administration. In these cases, this public bodies are allowed to delegate through a mandate convention signed with the Public Work Ministry, the concession of those works under its competence, with the purpose that then they delivered its concession, regulated by this law’.

Are there special rules for investing in energy and infrastructure?

Generally

Generally, there are no special rules regarding investing in energy. However, please note that some electrical installations and electrical services need prior electrical concession for their development (article 2° of the General Electric Service Law). Such concessions can be provisional (for study) or definite (for constructing the project or providing the service), and are granted directly to the interested party.

Regarding public infrastructure developed through the concession system, generally the invitation to tender defines the objective parameters and the State offers several guarantees such as guaranteed minimum returns, which minimize the risks involved in the projects. The Chilean banking institutions finance these kinds of concessions.

Energy

Our electrical legislation regulates, in different categories, the generation, transmission and distribution activities introducing certain limitations when the participants have interest in more than one segment. It is expected that the decisions of the different economic agents, operating in each of the generation, transmission and distribution phases, tend to higher efficiency levels than the ones vertically integrated operators could achieve.

Overall energy policy is based on a competitive model for power generation and wholesale commercialization, while energy distribution is considered a regulated monopoly with tariff setting processes based on a target return on asset set by law and efficient theoretical model
companies.

Ultimately, the Chilean electricity market encourages competition so that prices reflect the supply and demand balance, in an open market context in the segments which the economic conditions allow.

**Telecoms infrastructure**

All projects involving the use of radio electric spectrum will be within a regulated framework. Therefore, they will require landing rights to operate, which can be granted either by concessions, licenses or permits, depending on a series of elements, such as services providers and recipients, among others. Thus, once the specifics of a particular project have been settled, it will be possible to define precisely the kind of authorization required.

The radio electric spectrum is submitted to a bidding process, which is evaluated by reviewing the technical characteristics of the project. In fact, the award of the radio electric spectrum does not depend on the economical offers proposed by the interested parties, but only on technical criteria.

**Transport infrastructure and other infrastructure**

The transport infrastructure can be developed directly by the MOP with public resources and shall be award through a public tender process, considering the technical and economic factors stated in the applicable invitation to tender.

It is important to note, participation in the tender process requires the prior registration of the interested party in the Official Contractor Registry of the MOP, which considers different categories and specialties, depending the characteristics to the works and the investment involved.

In addition, the transport infrastructure can be developed through private resources by means of the concession system.

**What is the applicable procurement process?**

Regarding public concessions, the bidding process is an administrative procedure constituted by a set of formal acts by the authority and investors, legally regulated according to the applicable regulation and expressed through this predetermined proceeding, through which the State selects the bidding that offers the most advantageous conditions for the public interest, ensuring in every case the respect to the fundamental principles such the biddings publicity, the secrecy of each offer, equality among proponents and strict subjection to the bidding conditions.

**Investing in energy and infrastructure**

As a result of the privatization processes, Chile now presents an efficient, transparent and sophisticated electricity market with a regulatory framework based on a highly efficient model of free-market principles.

**GENERATION**

Generation is organized according to a competitive market model with several generating companies competing in the contract market and interacting amongst each other through the spot market, based on short term margin costs of the electric system.

**TRANSMISSION**

As an isolated segment, this is an activity that presents large scale economies regarding its particular cost structure which is why the procedures to establish payments for the use of transmission facilities is regulated in the energy regulation, according to a procedure that seeks to cover capital and operational costs.

**DISTRIBUTION**

Due to its monopolist nature and to the existence of economies of scale, this activity is organized around concessionary companies, with the obligation to provide services in their specific concession area and subject to the fixing of their tariffs by authorities, prices which are obtained from the analysis of capital costs and efficient model company operations.
Financing energy and infrastructure

Even though the energy market in Chile is highly complex and regulated, there are no specific rules in financing companies related to this industry.

However, the states provides several benefits, for example, in order to promote certain energy sectors, incorporating guaranteed minimum returns.

What are the most common forms of funding / investing in energy and infrastructure?

Funding

Through project finance and long-term agreements.

Investing

Through a special purpose vehicle that owns the project and is the holder of the permits involved in the same.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

Among others, there can be a regulatory investigation when:

- entities engage in regulated activities without the relevant authorizations;
- regulated entities publish misleading information regarding themselves or the securities they issue;
- brokers engage activities they are not allowed to, or fail to pass the relevant knowledge tests of the CMF; or
- financial institutions or banks issue financial promotions without the proper authorization from National Consumers Service or when they are misleading or false.

What regulatory penalties may apply?

The CMF is entitled to cancel the registry of a regulated entity if they violate the regulations contained in the Securities Act (whether if they are issuers or brokers). Fines can be applied and even suspension of the profession for the persons involved.

In addition, the General Banking Law establishes that the directors and managers of an institution subject to the supervision of the CMF who, knowingly, make false representation with respect to the ownership and capital contribution of the enterprise, or approve or submit a misstated or false balance sheet, or feign its situation, especially the amounts advanced to directors or employees, shall be punished with imprisonment.

In addition, the General Banking Law states that anyone who obtains loans from credit institutions, either public or private, supplying or providing false information or maliciously incomplete with respect to his or her identity, activities or statements of situation or equity, causing damage to the institution, shall be penalized with imprisonment.
What criminal penalties may apply?

The persons or legal entities engaging in banking activities, such as accepting deposit in a customary manner from the public or as broker, commits a criminal offence and is liable to imprisonment (from 541 days up to five years) and can also face charges as author of fraud.

Regarding the registry of securities, any person or legal entity that fails to obtain the proper authorization is liable and obliged to compensate damages due to the breach and shall be subject to administrative and criminal sanctions (imprisonment). In addition, in case of misleading information submitted before the CMF, criminal sanctions such as imprisonment may apply.

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

Stamp taxes are mainly applicable to documents evidencing indebtedness for borrowed money, including loans (between residents of Chile or cross-border), notes and bond issuances. The tax rate will depend on the characteristics of the debt but the tax rate will not exceed 0.8% of the principal amount of the debt.

Stamp tax must be paid on loans between residents of Chile when the contract or the documents are executed.

Stamp tax must be paid on cross-border loans when the document or contract is legalized in Chile or when the loan is accounted for in Chile (i.e. when the loan is recognized in the accounts of the borrower).

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Yes. The tax rate will depend on the term of the associated loan or credit. If the associated loan or credit provides for a fixed term, the mortgage, debenture or other security will be taxed at a rate of 0.066% per month. The maximum stamp tax rate is 0.8%. If the associated loan or credit does not have a fixed term, the mortgage, debenture or other security will be taxed at a rate of 0.322%.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

Yes, see above.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

According to the Chilean Civil Code, the tax authority takes priority over secured lenders and secured debt security holders for outstanding withholding taxes and surcharges.
Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Interest paid by borrowers resident in Chile to lenders not resident in Chile are subject to withholding tax in Chile. Repayments of loan principal are not subject to withholding tax.

If so:
What is the rate of withholding?

The withholding tax rate is generally 35%.

What are the key exemptions?

Interest paid to a lender not resident in Chile may benefit from a reduced withholding tax rate if:

- there is a double taxation treaty in force between Chile and the country of residence of the lender; or
- the interest payments are made to certain entities eg banks, financial institutions, insurance companies or pension funds.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Mauricio Halpern
Partner
DLA Piper Chile
mhalpern@dlapiper.cl
T: +56-2 2798 2611
Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Under Colombian law there are no restrictions on offering and selling debt securities but there are some requirements, including the following, that supervised financial institutions shall comply with.

- Debt securities must be registered in the National Registry for Securities and Issuers (Registro Nacional de Valores y Emisores (RNVE)).
- The Superintendency of Finance shall approve the specific regulations (ie rules and offering memorandum) for the issuance of securities by means of a public offer.
- For the issuance of notes convertible into shares or notes with the option for the subscription of shares, the issuing company shall have its shares listed on the Colombian Stock Exchange (CSE), in which its notes also have to be listed. Unsecured notes issued by the public offer shall also be listed.
- In case the issuance of debt securities is going to be made exclusively among the shareholders or between the creditors in order to capitalize the obligations of the issuing company, the securities do not need to be listed on the CSE.
- The value of the credit represented by the notes should not be less than 2,000 monthly legal minimum wages (approximately US$ 491,156 using an exchange rate of COP$ 3,004).
- The bond’s maturity period shall not be less than one year.

What are common issuing methods and types of debt securities?

Many different types of debt securities are offered in Colombia. Some common types are:

- **unsecured notes**: they are not secured by a specific asset;
- **notes convertible into shares**: this type of note can be converted into a predetermined amount of the company’s equity;
- **risk notes**: these instruments are issued by companies performing its corporate purpose under a restructuring agreement and represent the capitalization of liabilities of such companies;
- **syndicated notes**: notes issued by several companies;
- **secured notes**: Issued by a public warehouse and secured with a specific asset;
- **notes issued by multilateral lending institutions**;
• mortgage securities: Issued by credit institutions and backed with a real estate asset; and

• treasury notes: Colombian government debt securities.

What are the differences between offering debt securities to institutional/professional or other investors?

Colombian law does not make any distinction between offering debt securities to institutional/professional and other investors.

When is it necessary to prepare a prospectus?

Under applicable law, unless an exemption applies, it is necessary to prepare and publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer would not be deemed to have been made to the public if it is made solely to qualified investors, addressed to fewer than 100 identified investors; or is addressed to the issuer’s shareholders, so long as there are less than 500 shareholders; or if the issuer is a public utilities company which is offering its shares to investors who will benefit from investments in infrastructure.

What are the main exchanges available?

Trading system transactions are conducted through a stock exchange (currently the Colombian Stock Exchange – Bolsa de Valores de Colombia (CSE)), with the participation of an authorized broker, or through securities trading systems. The CSE provides its own set of regulations (for example, short selling, derivatives and listing regulations). The main securities trading platforms in Colombia are as follows.

• CSE manages and regulates three trading systems:
  • the Colombian Electronic Market (Mercado Electrónico Colombiano), through which securities other than public debt securities are traded;
  • the Colombian equity market; and
  • the standardized derivatives market.

• Electronic Trading System (Sistema Electrónico de Negociación) is one through which mainly public debt securities are traded, and which is managed by the Colombian Central Bank.

• Foreign Securities Quoting System (Sistemas de Cotización de Valores Extranjeros (SIC)) is one through which foreign securities are sponsored by a local broker for listing and trading. Only stock exchanges and administrators of securities trading systems that are under the Superintendency of Finance’s surveillance may administer the SIC. Retail investors are able to conduct transactions through this system.

• Over-the-Counter Market, different from the foregoing, covers securities transactions that are not conducted through the CSE or through a securities trading system and must be registered through a different registration system.

Please note that a Latin American exchange is the most significant recent project to enhance the local capital markets. Mercado Integrado Latinoamericano (MILA) is a project to unify the stock exchanges markets of Colombia, Chile, México and Peru in order to create a single stock market that will allow the negotiation of stocks of the most representative companies in the region. It is the result of an agreement signed among the aforesaid exchanges and its most important feature is that none of the entering exchanges compromises its autonomy or independence in regulatory or administrative issues as a result of the agreement. Instead, investors may benefit from MILA through an intermediary by using the local platform in local currency, but reaching the companies listed on any of the exchanges involved.
Is there a private placement market?

Yes, under applicable law a private placement should meet any of the following conditions:

- The offering is addressed to less than 100 identified investors.
- The offering is addressed to the issuer’s shareholders, so long as there are less than 500 shareholders.
- The issuer is a public utilities company which is offering its shares to investors who will benefit from investments in infrastructure.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for all the information incorporated in the prospectuses for debt securities. Misleading statements in, misrepresentations, or omissions from, any applicable offering document or information can give rise to both regulatory and criminal liability under Colombian law. Colombian regulation has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee (Fiduciary Institution), which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for at least one ordinary meeting of investors, to be carried out during the first three months of each calendar year, to consider matters affecting the investors' interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Under Decree 2555 of 2010 (Decree 2555), investment fund administration is a task that only brokers, investment administration corporations and trusts companies can perform. Moreover, in Colombia the securities of investment funds are not negotiated on the same platform used to negotiate stocks as a specific negotiation platform has been developed for listed investment fund securities. There is also regulation for specific types of investment fund, such as currency market, real estate, speculation and margin.

What are common fund structures?

Pooled funds

Decree 2555 sets forth the regulation of pooled funds (Carteras Colectivas) as financial vehicles created for raising and managing money or other assets from third parties to achieve collective economic results. These vehicles may only be managed by a fiduciary entity (Sociedad Fiduciaria), authorized brokers (Comisionista de Bolsa) or investment management companies (Sociedad Administradora de Inversión), which are responsible for the investments and the back-office activities on behalf of investors.

Decree 2555 establishes four different kinds of pooled funds:
• open-end, in which the participation units may be redeemed before the expiration of the fund's term;

• close-end, in which the units can only be redeemed upon expiration of the fund's term;

• staggered pooled funds through which placement rules define different terms for the redemption of the units before the expiration of the fund's term; and

• exchange traded funds.

Pooled funds are subject to the supervision and special regulation of the Superintendency of Finance and their shares are automatically registered with the National Registry for Securities and Issuers (RNVE).

Private equity funds

Private equity funds (PEFs) are special purpose vehicles, which are close-end funds (Carteras Colectivas Cerradas) that cannot invest more than one third of the fund's assets in publicly traded securities registered with the RNVE.

Venture capital

The venture capital industry is currently organized as a high-risk investment made through PEF, under the management of general partners, and with the concourse of angel and institutional investors.

What are the differences between offering fund securities to professional/institutional or other investors?

Colombian law does not make any distinction between offering fund securities to institutional/professional and other investors.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

The incorporation of private equity funds (PEFs) is not subject to the authorization of the Superintendency of Finance. Nonetheless, the management company of the PEF must deliver certain documents to the Superintendency of Finance at least 15 business days before the final closing date of the fund. Additionally, the placement terms of the PEF may establish that the investment decisions of the fund may be delegated to a general partner, whom must credit at least five years of experience in the administration of private equity assets to the PEF be deemed as an eligible investment for local pension fund managers and insurance companies.

Managing and marketing debt/hedge funds

Are there any restrictions on marketing a fund?

No, there are no restrictions on marketing a fund. However, the marketing of a fund is carried out by the management company of the fund and/or by the general partner.

Are there any restrictions on managing a fund?

The incorporation of private equity funds (PEFs) is not subject to the authorization of the Superintendency of Finance. Nonetheless, the management company must deliver certain documents to the Superintendency of Finance at least 15 business days before the final
closing date of the fund.

Additionally, the placement terms of the PEF may establish that the investment decisions of the fund may be delegated to a General Partner, which must credit at least five years of experience in the administration of private equity assets to the PEF be deemed as an eligible investment for local pension fund managers and insurance companies.

Pension funds are also allowed to invest in offshore PEFs managed by general partners that should credit five years of experience and additionally at least US$1 billion assets under management.

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**Entering into derivatives contracts**

*Are there any restrictions on entering into derivatives contracts?*

The derivatives contracts must be executed with entities under the supervision of the Superintendency of Finance (including commercial banks or broker institutions) duly authorized by such Superintendency to enter into derivatives operations. Also, the derivatives operations made through the Colombian Stock Exchange (CSE), shall comply with the all the rules set forth in the General Rules of the Derivatives Market of the CSE (Reglamento General del Mercado de Derivados).

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**What are common types of derivatives?**

Under applicable Colombian law, derivatives are classified in two categories:

- **standardized** – traded through the Colombian Stock Exchange (CSE), nonexistent counterparty risk because of the Central Counterparty Clearing House and constant liquidity (Market creators scheme); and

- **non-standardized** – traded outside the CSE (Over the Counter), existing counterparty risk, the contracts are created taking into account the client’s needs, and do not operate within a transactional system.

All of the main types of derivative contracts are widely used in Colombia:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Colombia are:

- equity;
- interest rate;
- commodities;
- foreign currency; and
- shares.

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*Are there any other notable risks or issues around entering into derivatives contracts?*

There are no specific risks or issues around entering into derivatives contracts.
Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Pursuant to applicable Colombian law, commercial banks cannot lend to a single person, directly or indirectly, a sum greater than 10% of their Tier 1 Capital (Patrimonio Técnico) if the only security for such operation is the borrower’s equity. Nevertheless, commercial banks can lend to a single person an amount equivalent to 25% of their Tier 1 Capital (Patrimonio Técnico), as long as such loan is secured by eligible collateral and sufficient to secure a risk exceeding 5% of such equity.

Notwithstanding the general rule set above regarding the lending limit of 10%, Decree 816 of 2014 was issued to promote the financing of fourth generation road concessions (Concesiones de Cuarta Generación), and establishes that commercial banks can lend to a single borrower who is pursuing a fourth-generation concession, a sum up to 25% of the Tier 1 Capital (Patrimonio Técnico).

Borrowing

Liabilities acquired by a Broker firm and intended to finance the acquisition of securities may not exceed three times its Tier 1 Capital (Patrimonio Técnico).

What are common lending structures?

The common structures of bank loans in Colombia are local or foreign loans, whether syndicated or not. Local loans are documented in a simple template promissory note and secured by personal guarantees. However, it is common to have foreign project finance structures for infrastructure projects with some complex guarantee structures covering assets and personal guarantees.

With respect to bank financing in Colombia for individuals, it is common to have mortgage loans, consumer credits, vehicle secured loans and leasing for housing or vehicles.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid; and
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled under the corresponding loan
agreement; or

- uncommitted, meaning that the lender has discretion whether or not to provide the loan if the conditions provided in the corresponding loan agreement are not fulfilled.

**Loan repayment**

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan), scheduled (usually meaning the loan is repayable in full at maturity), or prepaid.

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

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**Do the laws recognize the principles of agency and trusts?**

Yes, both principles are recognized as a matter of Colombian law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets and goods on trust for the lenders or secured parties.

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**Are there any other notable risks or issues around lending?**

**Generally**

The rate of default interest charged on a loan or on finance documents cannot exceed the maximum default interest rate authorized by the Superintendency of Finance for each calendar year.

**Specific types of lending**

Some of the most common specific types of lending are:

- mortgage loans;
- consumer credits;
- leasing for housing or vehicles; and
- vehicle-secured loans.

Please note that loans are not subject to registration. However, the granting of a mortgage over real estate requires the issuance of a public deed by a notary and the registration of the mortgage with the applicable land registry office, which triggers the corresponding registration tax as well as the fees charged by the notary plus the applicable VAT.

**Standard form documentation**

Most Colombian law finance transactions, including loan agreements are governed by documentation based on standard forms previously approved by the Superintendency of Finance.
Are there any other notable risks or issues around borrowing?

The personal information of the borrower and the information regarding the loan, payments, prepayments, accrued and due interest, and unpaid interest are sent by the financial institutions to the Risk Centrals (Centrales de Riesgo), for its custody. Such information will remain on the databases of the Risk Central, for a period determined by the applicable law.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Guarantees are commonly used in transactions where the borrower is a special purpose vehicle, a shell company or a vehicle with a limited balance sheet that is part of a group of companies that may provide stronger financial support. In this case, a parent guarantee or a guarantee from one or more affiliates is common.

Guarantees are generally created by a written agreement between the guarantor and the secured creditor.

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What are common types of guarantees and security?

Common forms of guarantees

In general terms, a guarantee can take the form of policies issued by authorized insurance companies domiciled in Colombia or abroad; or bonds issued by authorized commercial banks domiciled in Colombia or abroad.

If the policy or bond is issued by an insurance company or commercial bank domiciled abroad, the policy and the bond, as the case may be, must be confirmed by a local insurance company or local commercial bank.

A particular distinction is between a performance guarantee and a payment guarantee:

- A performance guarantee is a term used to describe both performance bonds and performance policies. A performance guarantee describes an undertaking used to protect a buyer and/or a contracting party against the failure of a supplier or contractor to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond or policy, as the case may be undertakes to pay to the buyer and/or contracting party a sum of money if the seller, supplier or contractor fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.

- A payment guarantee (whether policy or bond) covers the payment of money rather than other contractual obligations.

Additionally, the compliance policies may include some other protections such as: protection for wages and social benefits; and protection for the stability of the work.

Another common policy is the extra-contractual civil liability policy that has the following common protections: employer liability; contractors and subcontractors liability; cross liability; medical expenses; civil liability of owned and not owned vehicles; adjacent properties, cables and underground tubes.

Common forms of security

OVER REAL ESTATE

Mortgage

A mortgage allows the creditor to enforce it regardless of a transfer of ownership. The creditor cannot directly take ownership of the secured real estate. More than one mortgage can be granted over the same real estate, in which case the secured creditors are paid on a first-registered, first-served basis.
Security trust

The owner transfers the real estate to a professional trustee (entities supervised by the Superintendency of Finance) for the benefit of the secured creditors. Upon an event of default, the trustee must dispose of the real estate according to the instructions in the security trust agreement, and use the proceeds to pay the secured debt.

OVER MOVABLE ASSETS

Law 1676 of 2013 (Law 1676) unifies the legal framework for all kinds of security interest over movable assets, regardless of whether it is a conditional sale, security trust, pledge, title retention clause, or other form of security interest over movable property.

Law 1676 provides for different types of security interest, as follows:

- fixed security interest;
- purchase-money security interest; and
- floating security interest.

OVER DEMATERIALIZED SECURITIES

Security is created through both:

- a pledge agreement; and
- recording of the pledge through a book entry by the relevant securities' depository (generally, DECEVAL or DCV).

OVER SHARE CERTIFICATES

A security interest is created through a security agreement. The security interest is perfected by both:

- the secured creditor taking possession of the share certificates or registration with the National Registry of Security Interests; and
- registration in the company's stock ledger.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

In general terms, a guarantee can take the form of policies issued by authorized insurance companies domiciled in Colombia or abroad; or bonds issued by authorized commercial banks domiciled in Colombia or abroad.

If the policy or bond is issued by an insurance company or commercial bank domiciled abroad, the policy and the bond, as the case may be, must be confirmed by a local insurance company or local commercial bank. For more information, see Giving and taking guarantees and security – types.

Giving or taking security

Under applicable law, the options to secure loans are limited to mortgages, pledges, trusts over certain tangible and in existence assets, liens over other intangible, future assets and other movable assets and movable guarantees, including rights and actions.

Movable guarantees may be granted by means of an agreement executed by and between the guarantor and the creditor identifying the secured obligation, the amount and description of the assets subject to the guarantee. For this agreement to be opposable to third parties it must be registered in the public registry of movable guarantees. Notwithstanding the above, a movable guarantee will also be opposable by means of the tenancy of the asset by the creditor or the execution of an account control agreement for moneys deposited with financial institutions.
Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Organic Statute of the Financial System (Estatuto Orgánico del Sistema Financiero) (general statute of the financial system)

Law 964/2005 (Ley 964 de 2005) (structure and institutions of the financial system)

Decree 2555/2010 (Decreto Único) (structure of the financial system, securities and securities trading)

Legal Basic Circular (Circular Básica Jurídica - C.E. 029/2014)

Basic Accounting and Financial Circular (Circular Externa 100/1995 - Circular Básica Contable y Financiera)

Consumer credit

Financial Consumer Protection Regime (Régimen de Protección al Consumidor Financiero) (consumer protection regime)

Mortgages

Colombian Civil Code (Código Civil Colombiano)

Law 1555/2012 - Advance Payment of Credit Operations (Pago anticipado de operaciones de crédito)

Corporations

Colombian Code of Commerce (Código de Comercio Colombiano)

Legal Basic Circular (Circular Básica Jurídica - C.E. 029/2014)

Funds and platforms

Decree 2555/2010 (Decreto Único) (structure of the financial system, securities and securities trading)

Other key market legislation

Financial Consumer Protection Regime (Régimen de Protección al Consumidor Financiero) (consumer protection regime)

Anti-trust and Competition (Protección de la Competencia)

Habeas Data and Management of Information (Habeas Data y Manejo de la Información) (protection and management of the financial consumer information)

Regulatory authorization

Who are the regulators?
Central Bank

The Colombian Central Bank exercises the customary functions of a central bank, including price stabilization, legal currency issuance, regulation of currency circulation, credit and exchange rate monitoring and administration of international reserves. Its board of directors is the regulatory authority for monetary, currency exchange and credit policies, and is responsible for the direction and execution of the Colombian Central Bank duties. The Colombian Central Bank also acts as a last resort lender to financial institutions.

Ministry of Finance

The Ministry of Finance designs, coordinates, regulates and executes economic policy, seeking to create an optimal administration of public finances for the economic and social development of the country. The Ministry of Finance regulates all aspects of finance, securities and insurance activities, pursuant to powers conferred by the Colombian Constitution. As part of its duties, the Ministry of Finance issues decrees related mainly to financial, taxation, customs, public credit and budgetary matters that may affect banking transactions in Colombia. In particular, the Ministry of Finance is responsible for regulations relating to financial institutions' capital adequacy, risk limitations, authorized transactions, disclosure of information and accounting.

Superintendency of Finance

The Superintendency of Finance is a technical entity affiliated with the Ministry of Finance that acts as the inspection, supervision and control authority of persons involved in financial, insurance and securities exchange activities, and any other operations related to the management, use or investment of resources collected from the public. The Superintendency of Finance is responsible for supervising the Colombian financial system with the purpose of preserving its stability and trustworthiness, as well as promoting, organizing and developing the Colombian securities market and protecting the users of financial and insurance services and investors in general.

Financial institutions must obtain the authorization of the Superintendency of Finance before commencing operations. In addition, all public offering of securities requires the prior approval of the Superintendency of Finance.

Securities Market Self-Regulatory Organization

Self-regulation in the capital markets was formally introduced in Colombia by Law 964 of 2005, and the Securities Market Self-Regulatory Organization (Autoregulador del Mercado de Valores de Colombia, or SRO) was created in 12 June 2006.

The SRO is a private entity that has the power to supervise, sanction and regulate the entities subject to self-regulation (ie including securities intermediaries and any entity that voluntarily submits itself to self-regulation).

The SRO's supervisory powers entitle it to review compliance with applicable laws and regulations and impose sanctions in the case of violations. The SRO may also propose regulation aimed at various matters, including conflicts of interest and improving the integrity and quality of the capital markets.

What are the authorization requirements and process?

Depending on the type of entity, an entity must apply to the Superintendency of Finance for authorization.

The Superintendency of Finance must assess whether the application meets the minimum capital requirements and the other required conditions set forth by the applicable law, within six months of the submission of the complete application.

The Superintendency of Finance will also approve agents and professional individuals of the stock exchange market in their roles.

Authorized entities and individuals are listed on the National Registry for Securities and Issuers (Registro Nacional de Valores y Emisores), National Registry for Agents of the Stock Exchange Market (Registro Nacional de Agentes del Mercado de Valores) and on the National Registry for Professionals of the Stock Exchange Market (Registro Nacional de Profesionales del Mercado de Valores).

What are the main ongoing compliance requirements?
Minimum capital requirements are an ongoing compliance requirement for authorized entities.

On 24 August 2012, the Colombian government enacted Decree 1771 of 2012 which amended certain capital adequacy requirements for Colombian credit institutions set forth in Decree 2555 of 2010. Decree 1771 of 2012 maintains the requirement for a credit institution's technical capital to be at least 9% of that institution's total risk-weighted assets.

Since 1 August 1 2013, technical capital has consisted of the sum of basic capital (Patrimonio Básico), or primary capital (Tier I), and secondary capital (Patrimonio Adicional), or secondary capital (Tier II); however, primary capital (Tier I) will also consist of the sum of ordinary basic capital (Patrimonio Básico Ordinario), or Common Equity Tier 1, and a new category of additional basic capital (Patrimonio Básico Adicional), or Additional Tier 1.

In addition, Decree 1771 of 2012 introduced a new measure of 'core solvency' for Common Equity Tier 1, which requires higher quality capital and is set at a minimum of 4.5% of risk-weighted assets.

By means of Decree 1771 of 2012, the Colombian Government implemented some Basel III accords into the legal regime applicable to Colombian credit institutions, specifically with regard to the capital adequacy requirements as mentioned above.

What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized or exempt commits a criminal offence and is liable to imprisonment and economic sanctions.

Regulated activities

What finance and investment activities require authorization?

Generally

- Credit institutions (which are further categorized into banks, finance corporations, financing companies and finance cooperatives)
- Financial services entities
- Capitalization corporations
- Insurance companies
- Insurance intermediaries

Consumer credit

No financial, banking or credit institution may operate in Colombia without the prior approval of the Superintendency of Finance.

Subject to prior approval of the Superintendency of Finance, foreign banks may operate in Colombia through their subsidiaries established and incorporated in Colombia.

Under Law 1328 of 2009, foreign banks, as of 16 July 2013, are permitted to operate through their 'branches' and are not obligated to incorporate a Colombian subsidiary. Operations through these branches will be subject to prior approval by the Superintendency of Finance. Among others legal requirements, branches have to meet the same minimum capital requirements as independent entities do.

Each credit institution must be separately authorized by the Superintendency of Finance before it may develop and provide financial services. Furthermore, the activities of credit institutions are subject to limitations and restrictions, including limitations and restrictions relating to the extension of credit, risk concentration, investments, conditional operations, foreign currency loans and negotiations, and the administration of third-party funds. One of the principal restrictions on financial activities is that banks may not acquire or hold products, merchandise, shares of corporations, income bonds, or other similar securities, except:
• when the bank has received those goods or securities as collateral for loans it has made; or
• with respect to shares, when they are issued by companies where banks are permitted to hold investments (mainly financial affiliates).

Banks are also subject to other limitations, including limitations on lending activities.

Are there any possible exemptions?

No financial, banking or credit institution may operate in Colombia without the prior approval of the Superintendency of Finance.

The incorporation of private equity funds is not subject to the authorization of the Superintendency of Finance.

Do any exchange controls or other restrictions on payments apply?

General rule

According to the Colombian Exchange Code, the following operations must be channeled through the exchange market:

• importation and exportation of goods;
• foreign indebtedness of Colombian residents and financial costs inherent to these operations;
• foreign investments and their corresponding profits;
• Colombian investments abroad as well as their corresponding profits;
• foreign investments in securities or assets located abroad, unless said investment is made with funds that do not have to be channeled through the exchange market;
• securities and guarantees in foreign currency; and
• derivative operations.

The above-mentioned operations must be made through a foreign market intermediary and/or through a compensation account. Foreign market intermediaries are commercial banks, mortgage banks, financial corporations, commercial financing companies, Financiera Energética Nacional, Banco de Comercio Exterior de Colombia S.A., financial cooperatives, stock broker companies and foreign exchange agents. Such operations must be registered with the Colombian Central Bank through the filing of the corresponding form depending on each kind of transaction.

Prohibition to pay in foreign currency between Colombian residents

In general terms, Colombian residents should pay their mutual obligations in Colombian legal currency. However, since Resolution 1 of 2013, Colombian residents can pay and receive payments in foreign currencies as long as they do it through their compensation accounts.

What are the rules around financial promotions?

Financial promotions can only be done by financial, banking or credit institution duly authorized to operate in Colombia by the Superintendency of Finance.

Entity establishment
What types of legal entity are generally used to undertake financial or investment activity?

Pursuant to applicable Colombian regulation, financial and investment activities must be undertaken exclusively by legal entities under the form of Corporations (Sociedad Anónima) or Cooperative Associations (Asociaciones Cooperativas).

Corporations are body corporates with separate legal personality and limit the liability of their members.

Is it possible to conduct lending or investment business through a branch or establishment?

Under Law 1328 of 2009, foreign banks, as of 15 July 2013, are permitted to operate through their 'branches' and are not obligated to incorporate a Colombian subsidiary. Operations through these branches will be subject to prior approval by the Superintendency of Finance. Among other legal requirements, branches have to meet the same minimum capital requirements as independent entities do.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

MARKETPLACE LENDING IN COLOMBIA

Colombian lawmakers and regulators are currently drafting regulations regarding marketplace lending platforms. It is likely that the volume of lending as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.
Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (e.g. in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example, relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

BITCOIN IN COLOMBIA

Law 31 of 1992 sets forth that the Colombian peso is the only legal means of payment with unlimited releasing power. Thus, currently under Colombian law, bitcoin is not an asset that can be considered as equivalent to the legal currency and it has not been recognized as an authorized currency.

The Financial Superintendence of Colombia (SFC) considers that bitcoin can represent a risk to the Colombian financial sector as follows.

- Platforms are anonymous. Virtual currencies can be used in illicit or fraudulent activities, which may include unauthorized funding, money laundering and financing of terrorism.
- There are operational risks. Consumers may be exposed, as digital wallets can be hacked and unauthorized transactions cannot be reversed.
- There is a lack of guarantee. Consumers of virtual currencies are not covered by any type of private or public guarantee and their operations are not covered by any deposit insurance.
- There is a lack of enforceability. Currently there are no mechanisms to enforce transactions that include virtual currencies, which significantly increases the possibility of a default risk.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as
blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

SMART CONTRACTS IN COLOMBIA

Currently, smart contracts are not regulated under Colombian law. Smart contracts in Colombia are still in an early stage but they are expected to be found in different kinds of operations such as voting for a publication in a forum or actions with a higher level of complexity, such as loan guarantees and futures contracts, as well as transactions such as setting payment priorities in structured notes.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

CRYPTOCURRENCIES IN COLOMBIA

Currently, cryptocurrencies are not part of the Colombian stock market or any other platform and thus are not a valid investment for the regulatory authorities. There are at present no operators authorized to offer transactions that include cryptocurrencies.

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
nature of the project to which the tokens relate;

- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

ICOS IN COLOMBIA

Currently, ICOs are not regulated under Colombian law. As cryptocurrencies are not valid in Colombia, the offering of initial coins will be illegal.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

AI IN COLOMBIA

Although in Colombia, AI has not been regulated, there are firms that provide an AI service. For instance, customers may order products such as credit cards and insurance through an AI machine.

ROBO ADVISORY SYSTEMS IN COLOMBIA

In Colombia, while businesses offering such services are not closed to the use of algorithms and models that can provide a more efficient and adequate service, this type of advice is not yet fully automated. Currently it is the client who must still make their own portfolio adjustment or rebalance.

There are two main challenges regarding the implementation of robo advisory systems in Colombia:

- Most of the small financial entities do not have the required technology that allows them to connect with a robo advisory system.
- The lack of regulation means that financial entities are uninformed about this type of advice system.

Data analysis and cloud computing

WHAT IS DATA ANALYSIS?

According to the Organization for Economic Co-operation and Development (OECD), data analysis is the process of transforming raw data into usable information, often presented in the form of a published analytical article, in order to add value to the statistical output.

Data analysis provides the following support to a FinTech:

- mining data from various sources;
- using data to understand current consumer behaviors and predict future consumer behavior (this is known as ‘predictive analytics’);
- using data to predict what specific type of consumer will effectively purchase; and
- analyzing data from both internal sources and external sources.
WHAT IS THE DIFFERENCE BETWEEN BIG DATA AND DATA ANALYSIS

Big data is defined by the United Nations as the mass volume of data, structured and unstructured, that is too difficult to process within a traditional database and with traditional software. Big data platforms provide the ability to process mass volumes of data and to access and analyze information. For instance, data analysis's main objective is to examine raw data with the purpose of finding patterns in sets of specific information through the use of algorithms.

Under Colombian law, the National Development Plan law assigns to the National Planning Department the responsibility to design and regulate a big data strategy, which will become public policy with two main objectives, being to:

- use big data in the coordination of national planning, therefore maximizing public investment; and
- promote the participation and collaboration of the private sector in the design of the big data in order to resolve private social complexities.

BIG DATA IN COLOMBIA

Currently, many sectors are applying big data day to day, in order to improve production and efficiency. An example is rice production in Colombia. By working with Fedearroz, the rice producers' association in Colombia and the international center for tropical agriculture, the rice sector is developing strategies for using and sharing big data to make decisions on when to produce, how to produce, and how to use inputs more efficiently.

WHAT IS CLOUD COMPUTING?

The Ministry of Technology Information and Communications (MINCIT) defines the term 'cloud computing' as a technology that offers services within the internet, updating the traditional model of computing. MINCIT refers to the definition given by the National Institute of Standards and Technology, which indicates that cloud computing is a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources that can be rapidly provisioned and released with minimal management effort or service provider interaction.

CLOUD COMPUTING IN COLOMBIA

Currently in Colombia there are multiple cloud computing options (from Claro, Google, Microsoft and Amazon). According to the Colombian Chamber of Electronic Commerce (CCCE) the lack of cloud uptake is attributed to overregulation in the sector. Nonetheless, the Colombian government has initiatives to promote cloud computing and is procuring cloud services using Colombia Compra Eficiente Portal. Yet, CCCE determines that government agencies are reluctant to allow further development of cloud computing as it is still perceived as unsafe.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

REGULATORY ENTITY

The Financial Superintendence of Colombia (SFC) is a technical entity affiliated with the Ministry of Finance that acts as the inspection, supervision and control authority of persons involved in financial, insurance and securities exchange activities, and any other operations related to the management, use or investment of resources collected from the public. The SFC is responsible for supervising the Colombian financial system with the purpose of preserving its stability and trustworthiness, as well as promoting, organizing and developing the Colombian securities market and protecting the users of financial and insurance services and investors in general.

Financial institutions must obtain the authorization of the SFC before commencing operations. In addition, all public offerings of securities require the prior approval of the SFC.
A person must not carry on a regulated activity in Colombia, unless authorized by the SFC. The SFC authorizes the incorporation and operation of all financial institutions. Authorization of the SFC shall be obtained whenever FinTech products or applications involve any financial activity which requires regulatory authorization.

A person undertaking a regulated activity without being authorized or exempt commits a criminal offence and may be liable to imprisonment and economic sanctions.

**PROJECT REGTECH**

The SFC has a FinTech division that seeks to create and develop applications that support regulatory compliance. Currently, the main focus of the FinTech division is to optimize the transmission of information among the different financial controlled entities (i.e., banks, stock exchange, fiduciaries, and financial institutions). This initiative is known as ‘project RegTech’.

**FINTECH SUBCOMMITTEE**

In 2016, the Financial Regulation Unity (URF) formed the FinTech subcommittee to provide a formal space in which the public and private sectors may participate and contribute in the construction of FinTech regulations.

The remit of the FinTech subcommittee includes the following:

- robo advisors;
- cloud computing;
- blockchain; and
- algorithm tradition.

The FinTech subcommittee has not yet issued formal guidelines in connection with the abovementioned matters, although it is expected that it will issue these guidelines no later than December 2017.

**ASOCIACIÓN COLOMBIANA FINTECH**

Asociación Colombiana FinTech is a group of entities whose aim is to create a proactive place for the development of FinTech business in Colombia. This association is working in the following areas:

- international transmission of data;
- digital identity;
- digital consultancy;
- digital payment;
- crowdfunding;
- InsurTech;
- bitcoin and blockchain;
- open data for the financial sector; and
- sandboxes.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**ELECTRONIC PAYMENT PLATFORMS**

E-commerce is regulated by Law 527 of 1999, known as the Electronic Commerce Law. E-commerce is defined as all issues arising from a commercial relationship, whether contractual or not, originating from the use of one or more data messages or other similar media. Commercial relationships include the following transactions:

- supply or exchange of goods and services;
distribution agreements;
agency of mandate agreements;
all types of financial, securities and insurance operations;
infrastructure and construction agreements; and
licensing.

Electronic security is a component of the SFC’s operational risk review. Supervised firms are required to design and implement electronic security policies and contingency plans. The SFC establishes minimum requirements for security and quality of information transmitted through electronic channels.

Colombia has adopted measures aimed at reducing regulatory burdens on the financial sector with the aim of encouraging the expansion of access to financial services and to engage in online commerce. As an example, the financial inclusion law allows the creation of nonbank deposit entities known as specialized companies in deposits and electronic payments (SEDPE). SEDPEs are intended to give individuals access to a savings account, and facilitate safe, quick and cheap money transfers. SEDPEs help individuals who do not necessarily own credit or debit cards to carry out online purchases. Moreover, the law allows mobile phone operators to obtain financial licenses from the SFC to operate SEDPEs.

PEER-TO-PEER LENDERS

Peer-to-peer lenders are not currently regulated under Colombian law.

Regulation of payment services

The Financial Superintendence of Colombia has regulatory and supervisory authority over financial entities regarding payment services.

In addition, the Banco de la Republica (Central Bank or BR) is responsible for monetary policy and foreign exchange. It has the authority to adopt certain macroprudential measures, manages and exercises surveillance functions over the payment system, provides liquidity to markets, and acts as a lender of last resort.

Application of data protection and consumer laws

DATA PROTECTION AND CONSUMER REGULATIONS

Law 1266 of 2008, Law 1581 of 2012 and Decree 1337 of 2013, each regulate data collection and processing by any financial, commercial and credit institution. The regulations differentiate between the controller and the processor of the data. The data controller is any individual or legal, public or private entity, which by itself or in association with others, makes decisions regarding the database or the treatment of the data and is responsible for it. The data processor is any natural or legal, public or private entity, which by itself or in association with others, processes personal data on behalf of the controller.

DIFFERENCE BETWEEN TRANSFERRING OF DATA AND TRANSMISSION OF DATA

Regulations differentiate between the transferring of data and the transmission of data. The transferring of data is the operation in which the data controller of the personal data within Colombia sends the information to a receptor (in Colombia or abroad). In this case, the receptor also becomes responsible for the data processing, and therefore shall comply with all applicable laws. Transferring data to foreign countries is prohibited, unless the recipient foreign country is deemed to provide an adequate level of data protection. The transferring prohibition shall not apply, however, in the following cases:

- the owner of the data has authorized the transfer;
- exchange of medical information;
- bank transfers;
- transfers in accordance with international treaties;
- transfer is required due to the existence of an agreement between the owner of the information and the data controller; and
- legally required transfer in order to safeguard public interest.
Any event different from the above mentioned, requires the authorization of the Colombian Superintendence of Industry and Commerce (SIC).

For instance, the transmission of data is the communication between the data controller and the data processor in which the data is sent by the data controller and processed by the data processor on behalf of the data controller. International transmission does not require the authorization of the data owner, as long as an agreement has been executed between the data controller and data processor.

**Money laundering regulations**

Firms that are supervised and controlled by the SFC must implement an asset laundering and financing terrorism risk management system (SARLAFT) in order to prevent money laundering and terrorist financing. The SFC has the responsibility to report to the Special Administrative Unit and Financial Analysis (UIAF) any operations conducted by controlled or supervised firms that may be categorized as suspicious, in order for the UIAF to initiate an investigation.

The UIAF has the responsibility to detect, prevent and overcome practices related to money laundering and financing of terrorism by centralizing and analyzing all of the information collected in the exercise of its faculties.

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdcube or Crowdfunder.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

**ACCELERATORS**

There are various incubators or accelerators in the Colombian market which offer support, facilities and funding for startups, often in return for an equity stake. For example, INNPulsa Colombia, a governmental entity created in 2012, promotes and supports startups that are mainly focused in the productivity and business sector. Bancoldex, another governmental entity, finances any credit required by entities for working capital, fixed investments, and corporate capitalization.

**ISSUES OF CROWDFUNDING IMPLEMENTATIONS IN COLOMBIA**

Currently Colombian regulations do not permit crowdfunding services. However, mindful of the potential benefits of crowdfunding platforms, the Financial Regulation Unity (URF) is proposing reform to the current legal framework in order to allow crowdfunding in Colombia and, at the same time, ensure investor protection and stability for the financial system. The URF proposes three main strategies for a future regulation of crowdfunding in Colombia:
a clear definition in the law of ‘financial crowdfunding’;

to regulate the activity in order for it to be performed, exclusively, by entities under the surveillance and control of the Financial Superintendence of Colombia; and

to establish duties and conditions to be complied with by all parties that interact in the crowdfunding market.

**Venture capital and debt**

**VENTURE CAPITAL AND DEBT**

Venture capital (VC) is equity capital or loan capital provided by private investors or specialized institutions. It is a type of funding used to acquire new or growing businesses, including FinTech businesses. The VC firm provides funding to the startup company in exchange for equity in the startup. VC provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

In Colombia, the VC industry is currently organized as a high-risk investment through private equity funds, under the management of general partners and involving angel and institutional investors.

**DIFFERENCES BETWEEN VENTURE CAPITAL AND CROWDFUNDING**

The principal difference between VC and crowdfunding is equity. Investors acquire equity in the startup, crowdfunders do not. Generally, crowdfunding has a higher risk as it acts as a pre-order platform where there is a reasonable probability that the startup may fail to deliver the pre-order.

**Warehouse and platform funding**

Warehouse financing is a form of inventory financing in which loans are made to manufacturers and processors on the basis of goods or commodities held in trust as collateral for the loans. The goods may be held in public warehouses approved by the lender, or may be held in field warehouses located in the borrower’s facilities but controlled by an independent third party. A financial institution engaged in warehouse financing will usually designate a collateral manager who issues a warehouse receipt to the borrower that certifies the quantity and quality of the stored goods or commodities.

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date.

Law 1676 of 2014 provided a new legal framework on security interest over movable assets. The law introduced many changes but among the most important are:

- an increase in the kinds of assets that may be subject to a security interest;
- the creation of a new centralized system where filing and searches of security interests may be conducted; and
- new methods to enforce security interests against third parties and debtors.

This law promotes the use of warehouse and platform funding in Colombia.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Senior bank debt is a debt financing obligation issued by a financial institution to a company or individual that holds legal claim to the borrowers assets ranking above all other debt obligations. The debt is considered senior to all other claims against the borrower, which means that in the event of a bankruptcy the senior bank debt is the first to be repaid before all other interested parties receive payment.

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis, depending on the creditworthiness and asset base of the business.
Capital markets are the markets where securities such as shares and bonds are issued to raise medium to long-term financing, and where securities are traded. Securities may be issued by a company issuing shares or bonds to raise money. Bonds could also be issued by other entities in need of long-term funds.

Currently, in Colombia, FinTech companies have not issued bonds to invite investors as a way of raising funding, due to the lack of regulation.

Incentives and reliefs

There are certain provisions that incentivize specific platforms for FinTech business. For example, the last amendment of the Colombian Tax Code includes an incentive for the cloud computing platforms; cloud computing platforms shall be exempt from value added tax.

In addition, taking into account that it is expected that Congress will introduce a law that regulates FinTech businesses, the Asociación Colombiana FinTech has proposed that the legal FinTech framework includes tax deductions for:

- companies' vehicles and or structures that have, as a main objective, crowdfunding services;
- investors' funders or resource generators who interact with crowdfunding providers; and
- any financing or investment through a lending, crowdfunding or entrepreneur platform.

Portfolio sales

Loan transfers and portfolio sales

*What are common ways of buying and selling loans?*

Loans are commonly traded in Colombia. The most common forms of loans and debt trading are as follows.

**Assignment and assumption agreements**

The most common form of loan trading is an assignment and assumption agreement between the original lender and the new lender.

**Novation agreements**

For facilities in which the lender's obligations (mainly disbursement of the loan) are pending, the substitution of one lender by another is made through a novation agreement, executed by the lender with the debtor and the substituted lender.

*What are the main considerations when transferring a loan and related security?*

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets on Colombia varies according to the asset's sector. In general, public utilities and infrastructure services must be provided by the state, but they can engage private sector investment through concession contracts that grant to a private individual or company the provision or operation of a public service or the construction of a work or good.

Additionally, the government issued the Public-Private Partnership's (PPP) regime (Law 1508 of 2012) to attract long-term investors with enough financial capacity to develop:

- the design and construction of infrastructure and its utilities;
- the construction, rehabilitation, improvement or equipment of infrastructure, including the operation and maintenance of the infrastructure; and
- infrastructure for providing public services.

Projects typically use a BOOT structure where at the end of the 30-year concession period, the infrastructure reverts to the public sector who will own and operate it, or grant it in concession again to a different investor. PPPs can be structured to develop infrastructure in any sector in which the provision of infrastructure and its related services are needed and to projects with a minimum investment of US$1.7 million. There are two type of PPPs:

- Public Initiative PPPs structured by the government that can be developed using private and/or public resources; and
- Unsolicited Proposals PPPs that are structured by a private company (only for new projects) which can be funded 100% with private resources or with private resources and a maximum of 20% public funds.

Colombia's main privatizations have occurred in the electricity, mining and hydrocarbon sectors. Under Law 226 of 1995, the state can privatize state-owned companies by alienating the shares or convertible bonds owned by the government in a company's capital by offering them to the company's cooperatives and workers associations in the first place. If they show no interest, the government can then proceed to offer them to the general public. In addition, the Constitution allows for the government to create mixed-economy companies that are jointly owned by the public and private sectors. These companies, organized under the structure of a joint-stock corporation, can own and operate infrastructure assets or provide infrastructure services.

Energy

The private sector finances and delivers most of the required infrastructure in the energy sector.

ELECTRICITY

The electricity sector in Colombia is a complex system comprised of generation, transmission, distribution, commercialization and interconnection activities. The economic agents who can participate in this sector's activities are public-owned companies, private companies and mixed-economy companies.

The construction of energy generation facilities and its connecting power lines to the interconnection and transmission networks can be performed by any economic agent, which maintain the ownership of the assets. In addition, companies that own power lines, substations and facilities that are part of the National Interconnection Network, as well as electricity transmission and distribution assets, also maintain their ownership.
MINING AND HYDROCARBONS

Subsoil and mineral resources are owned by the state. However, the state doesn't participate in oil and gas production or mineral extraction as these activities are performed by private companies and ECOPETROL, a mixed economy company, through concession contracts (mining) and exploration and production contracts (hydrocarbons) granted by the National Mining Agency and the National Hydrocarbons Agency respectively.

The Regulation Commission for Energy and Gas (CREG) and the Mining and Energy Planning Unit (UPME) are the principal state agencies responsible for regulating the energy sector and market in Colombia.

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in Colombia can be publicly or privately owned operators and service providers.

The electromagnetic spectrum is a public good subject to the state's administration and control. Law 182 of 1992 (modified by Law 335 of 1996) introduced a reform in this sector in Colombia by establishing the possibility for private companies to provide television services through national operation private channels. In addition, television services can be provided by public entities and organized communities.

Transport infrastructure

AVIATION

Air transportation in Colombia is considered a public service. There are several ownership structures in Colombia's aviation market, including private aerodromes and public aerodromes operated by territorial entities or by private companies that operate them under concession contracts. However, airports are owned by the state but constructed and operated by a private company under a concession agreement that usually lasts 20 years. These concessions were previously granted and managed by the Civil Aviation Authority but recently the National Infrastructure Agency (ANI) took over this task.

PORTS

Ports in Colombia are constructed and maintained by port-operating companies organized as joint-stock companies, which can be publicly owned, privately owned or jointly owned by a private company and a public entity. Only port-operated companies can be granted with a port concession contract for a 20-year period.

RAILWAYS

Two mining companies privately own the only two standard gauge railways that currently exist in Colombia. However, private initiative PPP projects have been presented to the ANI and are under study in its feasibility phase for financing and operating the currently inactive lines.

ROADS

Road and highways in Colombia can be classified into four categories:

- national road network under concession, financed and operated by private companies;
- non-concessional national road network financed by the national government and operated by the National Roads Institute;
- secondary road network, financed and operated by departments; and
- tertiary road network financed and operated by municipalities.

Road infrastructure in Colombia linking private participation has been developed through three generations of concession contracts to finance, design, build, operate and maintain highways. A fourth generation of concessions was launched in 2012 under the PPP scheme, where private investors can participate in public initiative PPPs bidding processes or present unsolicited proposals to be entirely founded with private resources or with both public and private funds.

PUBLIC TRANSPORTATION
The Massive Transportation Integrated Systems (SITM) were recently implemented in Colombia's major cities for improving urban public passenger transportation. The construction of the infrastructure (e.g., lanes, stations, stops) needed for the SITM’s was performed by private construction companies who were awarded with a public works contract by the city's government. For the operation of the systems, local governments award 10-year concession contracts, some for purchasing, maintaining and operating the buses and others to operate the payment collection systems.

Other infrastructure

RESIDENTIAL PUBLIC UTILITY SERVICES

Water supply, sewage, sanitation, electric energy (transportation to final user), natural gas distribution, basic public telephone and mobile telephone in rural areas are considered as residential public utility services, and must be provided by a Public Utility Company (Empresa de Servicio Público Domiciliario (ESP)), incorporated under the structure of a joint-stock corporation. ESP shareholders may be companies or individuals from the private sector, public sector entities or mixed economy entities. Even though a single ESP may provide more than one public utility service, the regulatory agencies (Water and Basic Sanitation, Energy and Gas and Telecommunications) may limit the ESP’s business to only one service to prevent monopolization.

DEFENSE AND NATIONAL SECURITY

Typically, defense assets are owned by the public sector. However, private companies can provide goods and services required for this sector to the government.

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, PENITENTIARIES, PUBLIC BUILDINGS)

Typically, infrastructure from these sectors is owned by the public sector. Most social infrastructure assets in Colombia are directly financed by the government. However, the goal is to attract private investment through PPPs to develop these sectors that have traditionally been left behind.

Are there special rules for investing in energy and infrastructure?

Generally

Whether a specific investor can invest in a particular project will depend on the terms of the project's procurement if it is carried out by the public sector. Regarding an existing/operating project, the possibility for a private company to invest will depend on whether there are any contractual restrictions on change of control or contract assignment.

On private sector infrastructure, the investor would need to consider the need of licenses (i.e., construction, environmental, planning), previous consultations, entity's consents or permits to carry out the project.

Energy

The energy sector in Colombia is highly regulated and controlled by the Regulation Commission for Energy and Gas (CREG) and the Mining and Energy Planning Unit (UPME) which are the principal state agencies responsible for regulating the energy sector and market in Colombia. These public entities are currently issuing new resolutions regarding regulated and non-regulated users, the tariffs to be charged to the final users, subsidies and the elaboration/update of the National Energy Expansion Plan. Investors should keep in mind if they will be developing in the regulated or non-regulated segments of the energy market, and the advances in the implementation of the regulation regarding alternative energy that was issued in 2001 but that has not had much development yet.

Telecoms infrastructure

Under the regime introduced by Law 1341 of 2009, all telecommunications services (ICTs) may be freely provided without any license or authorization; the only requirement is for the provider to be registered in a public record. The Communications Regulatory Commission is the state agency in charge of regulating the ICTs sector in Colombia.

Regarding television, all agents must have a license or contract granted by the National Television Agency for operating and providing
television services that usually lasts 10 years.

**Transport infrastructure**

For a private sector sponsor to carry out a highway project, the company must meet the enabling requirements established by the National Infrastructure Agency (ANI) in a prequalification stage previous to the bidding process: experience in financial investment or project structuring/development and financial capacity. Once the contract is awarded by the ANI, the private investor that will act as a sponsor must constitute a special purpose vehicle (SPV) to execute the specific project that constitutes the object of the contract awarded by the ANI. In addition, the SPV must constitute a trust fund that will manage the project's equity investments, the debt originated by the lenders, the toll-road collection funds, the commercial exploitation money and the government's resources when the project requires public funds (*Vigencias Futuras*).

There is usually a restriction on the change of control of a private sector sponsor in these highway projects: during the pre-operation phase (pre-construction and construction) and until the first year of the operation and maintenance phase, sponsors may assign their participation but the SPV has to maintain as a shareholder holding a 25% equity interest, a party that presented financial and experience requisites during the bidding process; and after the first year of the operation and maintenance phase until the end of the concession without restrictions.

**What is the applicable procurement process?**

Public Procurement in Colombia is governed by the General Statue for Public Procurement, composed by Law 80 of 1993, Law 1150 of 2007 and Decree 1082 of 2015. The following are the sector-specific regulations that are excluded from the application of the general regime:

- Residential Public Utility Services are governed by Law 142 of 1994 and subject to private law regime.
- Electric energy activities are governed by Law 143 of 1994 and subject to private law regime.
- Telecommunications are governed by Law 1341 of 2009; (iv) Ports are governed by Law 01 of 1991.

Contracts procured by the public sector must be awarded following the principles of objective selection, transparency, economic efficiency, planning, publicity and responsibility. All public contracts must be awarded through a public tender unless the regime establishes specifically that a given contract must be awarded following one of the exceptive procedures. However, in all cases the public entity will need to publish the procedure's terms of reference and contractual documents in the electronic system SECOP. The following are the five selection procedures for awarding public contracts:

- **Public tender** – This selection process is used by state agencies to select contractors through a public invitation that is extended to all people interested in entering into a contract with such entity so that they, on equal conditions and following an established objective criterion, submit their proposals, from which the most favorable will be selected.

- **Abbreviated selection** – This procedure is used in cases in which the characteristics of the object to be contracted, the circumstances of contracting, or the value or destination of the goods or services may be contracted by an expedited public tender. It is allowed in the following instances:
  - when the good to be acquired has uniform technical characteristics and are of everyday use by state entities;
  - for minor amount contracts, determined based on the annual budget of the contracting entity;
  - for celebrating contracts for the provision of health services;
  - in the cases when a public tender process has been declared deserted (without suitable bidders);
  - for the alienation of public assets;
  - for acquiring goods produced or intended for agricultural purposes that are offered on legally constituted product exchanges;
  - for celebrating contracts that have as an object the commercial and industrial activities inherent to industrial and commercial state entities;
  - the contracts of entities dedicated to the execution of programs regarding protection to individuals in risk, demobilization and
• reinsertion to civil life of people belonging to armed groups, displaced population, human rights protection, and population in high risk of vulnerability; and

• for acquiring goods and services required for national defense and security.

**Merits-based contest** – This selection process must be used only to select contractors for consultancy projects in which the work is mostly intellectual and so the public entity must consider the bidder's professional qualities or technical expertise instead of the price of the services.

**Direct contracting** – This is an exceptional selection mechanism since its application is restricted to the following events only:

  • when the public entity has declared that the contract must be celebrated to ensure the continuity of the service ('urgencia manifiesta');

  • for contracting loans;

  • for celebrating inter-administrative contracts;

  • for the confidential contracts celebrated to acquire goods and services required for national defense and security that must be kept under reserve;

  • contracts for the development of scientific and technological activities;

  • escrow agreements celebrated by regional entities;

  • when there are no other suppliers in the market for the provision of the good or service; and

  • for the provision of professional services and administrative support, or for the execution of artistic works that can be only entrusted to specific individuals.

**Investing in energy and infrastructure**

The selection mechanisms and rules for the celebration and execution of public-private partnership (PPP) contracts are also ruled by the General Statue for Public Procurement. However, the selection mechanism that applies depends on the project's initiative (public or private) and if it requires public funds, according to what is prescribed in Decree 1467 of 2012.

**PUBLIC INITIATIVE PPP**

The selection mechanism that must be selected by the public entity is the public tender. However, the entity can choose to open a prequalification round where the investor's financial and experience capacities will be evaluated when the project's estimated value exceeds US$17 million.

**UNSOLICITED PROPOSAL PPP**

**Funded 100% by a private investor**

Once the state entity approves the project presented by the originator in its feasibility phase, it must publish a public call for third parties to manifest if they are interested in the project structured by its originator. If no other companies show their interest, the state agency can award the contract directly to the project's originator. If other companies manifest an interest in the project, the state entity must open an abbreviated selection process to award the contract. During the public process, the originator has the right to present a second offer improving the value of the offer that was qualified in the first place. If, even by exercising its right, the originator doesn't obtain the first place, the company has the right to be compensated by the winning offeror for the costs incurred when structuring the project.

**Funded by a private investor with 20% public funds**

The investor has to be selected through a public tender process. The project's originator will have a 3% to 10% bonification in its final qualification during the tender process as a reward for its previous efforts in structuring the project.

An investor may choose, however, to seek to invest in a project that has already been procured and is operational. A special purpose vehicle (SPV) project company's shareholder may assign its contractual position to the shareholder, in which case such investments are controlled by the state entity who awarded the contract as procurement regulations establish that the assignment must be previously approved by the awarding entity. Moreover, an investor can also invest in an ongoing project by acquiring an interest in an SPV project.
company, where typically such investments are controlled by contractual mechanisms within the original contracts celebrated between the SPV's shareholders.

**Financing energy and infrastructure**

Publicly procured contracts include a disposition that states that the SPV must register the lenders before the public entity and any change on the funding arranged, requires consent from the public sector. In addition, contracts provide that if the SPV incurs in a breach of any of the financial documents or contracts entered with the lenders, these have a step-in right to control the project.

**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

In Colombia, energy and infrastructure finance needs are met mainly by national or international commercial banks, nonbank finance companies (Corporaciones Financieras) and private equity funds that act together with multilateral agencies to serve as project lenders. Recently, insurance companies and private pension fund administrators have acted as financing sources for infrastructure projects.

Common forms of funding in energy and infrastructure include:

- syndicated bank loans made on a project-finance basis to a special purpose vehicle (SPV) project company, on medium- to long-term bases;
- private equity fund loans;
- project notes; and
- refinancing of the debt in the operation phase of the project.

Colombia's government has tried to expand the funding base and increase liquidity in the market by various means. Recently, the Financiera de Desarrollo Nacional was created as a mixed-economy financial company that offers financing, guarantee and advisory services for energy and infrastructure projects.

**Investing**

Large engineering and construction companies act as sponsors in the development of infrastructure projects, while oil producers and energy agents are the companies that invest in the energy sector.

Common forms of investing in these sectors include:

- equity investment in project's SPVs in the form of share capital or subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of 'equity').

**Restructuring**

**Enforcement and sanctions**

**When can there be regulatory investigations?**

Violations of the financial system rules and regulations are subject to administrative, and in some cases, criminal sanctions.

The Superintendency of Finance exerts its supervisory powers over the financial sector on a consolidated and comprehensive basis. The consolidated supervision extends to all financial institutions including banks operating in Colombia and their subsidiaries abroad, in the latter case to the extent permitted by the laws of the respective country of incorporation.
The Superintendency of Industry and Commerce is responsible for advancing administrative investigations of antitrust violations by financial and non-financial corporations, and has the power to impose corresponding sanctions.

What regulatory penalties may apply?

The Superintendency of Finance may inspect Colombian financial institutions on a discretionary basis and has the authority to impose sanctions including admonitions, fines, removals, or administrative takeovers on such institutions and their directors and officers for violations of Colombian laws or regulations, or such financial institutions’ by-laws.

If a financial institution exceeds the lending and investment limits as set forth in the applicable law, the Superintendency of Finance may impose a fine up to twice the amount by which any such loan exceeded the limit and, in some cases, there may be criminal sanctions.

What criminal penalties may apply?

The Colombian Criminal Code introduced criminal rules and regulations to prevent, control, detect, eliminate and prosecute all matters related to financing terrorism and money laundering. The criminal rules and regulations cover the omission of reports on cash transactions, mobilization or storage of cash, and the lack of controls.

Tax

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There is no stamp, registration, or other similar tax payable on loan agreements, bonds or other debt instruments.

Documents granting security (e.g. mortgage instruments) that have to be registered either on the Public Deed Registry, or before a Chamber of Commerce, are subject to:

- a registry tax that ranges between approximately US$30 (for ‘documents without amount’) and 1% of the contract amount, depending on the specific characteristics of the document to be registered; and

- a registry fee which ranges from approximately US$6 (for ‘documents without amount’) to 0.5% of the contract amount.

In most cases, mortgage instruments are considered ‘documents with an amount’, and therefore subject to registry tax and fees calculated as a percentage (and not the fixed amounts mentioned above).

The execution of a public deed is subject to the payment of notary fees which, in the case of a mortgage, amount to 0.3% of the secured amount (plus a 19% value added tax on the notary fee). This also applies to instruments which are granted through public deed without a legal requirement to do so.

Liens over personal property such as shares, intangibles, and accounts receivable, are not subject to registry tax, as they are not inscribed in the Public Deed Registry or Chamber of Commerce but rather in the Personal Property Securities Registry, which charges a fixed registry fee of approximately US$10.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or
assignment of a mortgage, debenture or other security?

The transfer or assignment of a mortgage would, in principle, be subject to the registry taxes and fees, and notary fees since, in practice, these transfers or assignments are carried out through a cancellation of the pre-existing mortgage and the creation of a new mortgage.

The documentation of the substitution of mortgaged assets, without a change in parties or the secured obligations, is deemed by regulation as a ‘document without amount’ (such that the fixed amounts mentioned above are applicable).

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

The assignment of a security over personal property (eg shares, intangibles and accounts receivables) is subject to a fixed registry fee of US$10, payable to the Personal Property Securities Registry.

Bonds, promissory notes, loan agreements and similar debt instruments are not required to be registered with the Public Deed Registry or before a Chamber of Commerce, nor are they required to be incorporated on a public deed, and therefore are not subject to the aforementioned taxes and fees (which are normally charged upon securities and not upon debt instruments).

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Under current applicable law, the liabilities of a borrower in insolvency proceedings are discharged in the following order of priority:

- expenses incurred after the start of the insolvency proceedings;
- pension liabilities;
- liabilities covered by a security interest up to the amount of the security interest;
- tax obligations (enforcement by the Colombian Tax Authority (Dirección de Impuestos y Aduanas Nacionales (DIAN)), or the local tax administration, depending on the tax due);
- other kinds of liabilities; and
- unsecured liabilities.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Interest payments made under a loan from Colombian source income are subject to withholding tax. According to Colombian tax law, the source of interest income depends on the domicile of the debtor.

If so:
What is the rate of withholding?

The general withholding tax rate for interest payments made by a person resident for tax purposes in Colombia to a recipient who is not resident for tax purposes in Colombia, is 15%. This rate is increased to 34% (33% from 2018) when the recipient is resident for tax purposes in a country listed by Colombia as a non-cooperative or low tax jurisdiction.

What are the key exemptions?
Interest payments on loans granted by persons not resident for tax purposes in Colombia to Colombian banks, financial cooperatives, commercial finance companies, financial corporations, the Colombian Nation and territorial authorities, as well as certain government-owned finance agencies (Bancoldex, Finagro and Findeter), are not considered Colombian source income and are, therefore, not subject to withholding taxes or income taxes.

Interest payments arising from loans intended to finance public infrastructure projects in Colombia, and granted for a term equal to, or longer than, eight years, could be subject to a reduced 5% withholding tax rate.

The double tax treaties entered into by Colombia may allow for a reduction of the general withholding tax rate (normally to 10%), provided that the conditions set forth in the applicable treaty are complied with (such as the recipient being the effective beneficiary of the interest, and not a mere conduit entity).

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes. However, the Colombian Tax Administration recently changed a doctrine that has been in place since 2013, to accept an exception from withholding tax for interest payments on bonds and other debt securities issued outside of Colombia by a Colombian resident, provided the bonds or other debt securities are not traded on the Colombian markets. According to this new interpretation, there would not be withholding taxes in these cases.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

Lenders who are not resident in Colombia and whose only Colombian source income are interest payments, are not required to file an income tax return in Colombia, provided that any applicable withholding tax has been adequately charged. In this event, the withholding tax becomes the final tax due in Colombia. If these conditions are not fulfilled, an income tax return is due and the tax has to be calculated according to the general rules (which tax the profits of foreign lenders on a net, rather than gross, basis at a rate ranging from 33% to 40%).

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes. However, if the exception from withholding tax for interest payments on debt securities issued and traded outside of Colombia applies, an income tax return would not be required.

Key contacts

Camilo Martínez
Partner
DLA Piper Martinez Beltran
cmartinez@dlapipermb.com
T: +57 1 317 4720
Capital markets and structured investments
Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Yes.

There are restrictions on offering and selling debt securities under both the Czech and EU law. The main restrictions under Czech law are contained in the Act No. 190/2004 Coll., on Bonds.

Any joint-stock company can issue debt securities unless forbidden by law, eg investment funds cannot issue debt securities.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in the Czech Republic are corporate bonds. However, government bonds (issued either by state or municipalities) are also quite common and very favored by foreign investors, especially in recent years (their yield is not high, but they are considered a safe choice).

Different types of debt securities are offered in the Czech Republic:

- corporate bonds;
- state bonds (via ministry of finance);
- municipality bonds;
- ordinary shares;
- bank bonds (subtype of corporate bonds); and
- mortgage bonds (Hypotení zástavní listy in Czech).

Debt securities are also characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds.

What are the differences between offering debt securities to institutional / professional or other investors?
Differences are further described in Act No. 256/2004 Coll., on Capital Market Undertakings. The entity issuing debt securities is bound by Sections 15 to 15r when offering debt securities to professional investors, eg some information duties.

The Prospectus Directive does not make a distinction between professional and other investors for the purposes of its disclosure requirements but does include different disclosure regimes by reference to the minimum denomination of a single security. If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the ‘wholesale’ rules apply. If the denomination is under €100,000, the ‘retail’ rules apply. Additional disclosure requirements apply for retail securities.

**When is it necessary to prepare a prospectus?**

Under the Prospectus Directive, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer would not be deemed to have been made to the public if it is:

- made solely to qualified investors;
- addressed to fewer than 150 persons (other than qualified investors) per European Economic Area state; or
- where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a Prospectus Directive compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market.

An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

**What are the main exchanges available?**

The Prague Stock Exchange has two principal markets on which debt securities are traded:

- Official Market; and
- Regulated Market.

**The Prague Stock Exchange Official Market**

The Official Market is intended exclusively for trade in the largest and most prestigious bonds issued by the entities coming from the public administration, corporate and financial sectors.

If they adhere to the statutory rules of the Official Market they must primarily meet the criterion of minimum issue value of €200,000.

**The Prague Stock Exchange Regulated Market**

The Regulated Market is intended for trade in the major bonds and other debt securities issued by the entities coming from the public administration, corporate and financial sectors.

The Regulated Market may accept the issues which meet the less demanding statutory requirements of the Regulated Market.


**Is there a private placement market?**
Yes, the Czech Republic has an active private placement market. Private placements are regulated by Act No. 240/2013 Coll., on Investment Companies and Investment Funds.

There is no dominant standard for documentation.

**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Issuers are required to take responsibility for prospectuses for debt securities. The Czech National Bank supervises compliance with the legal regulations when issuing debt securities. The Czech National Bank has a wide range of powers.

In the case of breach of the legal regulations, it can impose forced administration and forbid the issuing of debt securities for a period of 10 days. In the Criminal Code, there is also a general crime of fraud. Where this applies, a criminal liability can also arise.

**Investing in debt securities**

There is a risk of the decline in the credit ranking of a company which issued the debt security. Corporate debt securities can also be more difficult to sell due to the prevailing market conditions.

**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**

**Generally**

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the Act on Investment Companies and Investment Funds and therefore are subject to regulation by the Czech National Bank.

Collective investment is usually a business activity involving collection of financial funds from investors for investing into something based on a pre-defined investment policy for the benefit of people whose funds were collected for such purpose.

**What are common fund structures?**

Common forms of funds include:

- funds of collective investment, which can only be: common funds or joint-stock companies. They are divided into standard funds and special funds as well as open-ended and closed-ended funds;
- qualified investors structure, which can only be: common funds, trust funds, limited partnerships, limited liability companies, joint-stock companies or cooperatives; and
- foreign investment funds.

**What are the differences between offering fund securities to professional / institutional or other investors?**
Retail funds

Raising of funds on the basis of a public offer of securities or equity participation in domestic investment funds with variable capital (which are companies established in the Czech Republic) is prohibited.

Distribution of securities or equity participations in domestic investment funds with variable capital (which are companies or cooperatives established in the Czech Republic) can be carried out only by private offers and/or to professional investors.

Qualified Investors Fund

According to Section 272 onwards of the Act on Investment Companies and Investment Funds, a Qualified Investors Fund is a special fund of qualified investors and domestic investment funds, and is a company or a cooperative established in the Czech Republic. The creation of a Qualified Investors Fund is not subject to licensing in accordance with the Act on Investment Companies and Investment Funds but the Act regulates other aspects, such as the statute (or constitution) of the fund or requirements of audit and annual reports.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

The only other issue is the requirement that the fund must be registered with the Czech National Bank.

Investing in funds

Unlike bank deposits, the main risk regarding investing in funds is that they are not insured.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Under Czech Law, offering securities was formerly covered by either the Act No. 189/2004 Coll., on Collective Investment or the Act No. 591/1992 Coll., on Securities. Both of these Acts have, however, been replaced in the process of recodification in 2014 and the offer of securities is since been included in the Act on Investment Companies and Investment Funds. The definition of securities itself is in the Czech Civil Code.

Undertakings for Collective Investments in Transferable Securities (UCITS)

In the Czech Republic, standard funds (ie mutual funds or investment funds with variable capital) are considered UCITS.

Alternative Investment Funds (AIFs)

A management company which decides to distribute securities or equity participations in AIFs or European AIFs it manages in another member state, is required, prior to the commencement of such activity, to notify its intention to the Czech National Bank.

Are there any restrictions on managing a fund?

Any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization (which is granted by the Czech National Bank and includes financial, personnel and organizational conditions), unless any statutory exemptions apply.
The main administrator of a fund must own a base capital amount of at least €50,000 which must be maintained for the whole duration of the fund. The fund manager is obliged to act diligently in all matters and keep all evidence required by the Act on Investment Companies and Investment Funds.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Any person entering into a derivative contract in the Czech Republic (such as a financial agent) has to be authorized under the Act on Investment Companies and Investment Funds.

Both financial intermediation and provision of investment services include activities such as:

- forwards;
- futures;
- swaps; or
- options.

The European Market Infrastructure Regulation applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

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What are common types of derivatives?

Pursuant to the Act on Investment Companies and Investment Funds, all of the following main types of derivative contract are recognized under Czech law:

- forwards;
- futures;
- swaps; and
- options.

The value of derivative contracts is based on the value of the underlying assets. The main classes of underlying asset in the Czech Republic are:

- securities;
- interest rates;
- exchange rate indices of funds held in Czech Crowns or a foreign currency;
- securities contracts; and
- commodities.

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Are there any other notable risks or issues around entering into derivatives contracts?

The biggest issue is the level of regulation which became more stringent after the global financial crisis in 2008, which was partially caused by mortgages and over-the-counter derivatives. Therefore, there is now more central counterparty clearing and more
standardized derivatives contracts, both to increase the transparency and safety of this kind of contracts.

It is likely that there will be even more regulation in upcoming years on both Czech national and EU levels.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the Czech National Bank (CNB) to conduct such business.

Consumer credit is a specific area of regulation. The set of entities subject to consumer credit supervision by the CNB was recently widened with effect from 1 December 2016. Non-banking institutions can provide consumer credit only if they comply with conditions set in the Consumer Credit Act.

Consumer credit regulation pertains to:

- consumer credit providers;
- consumer credit intermediaries; and
- accredited entities organizing professional examinations pursuant to the Consumer Credit Act.

There are some additional restrictions that apply to foreign lenders making loans to Czech borrowers, eg a foreign bank which wants to create a branch in the Czech Republic has to submit a special statement from the institution carrying out bank supervision in the home country of that bank.

There is also the Central Credit Register (CCR) which is an information system that pools information on the credit commitments of individual entrepreneurs and legal entities, and facilitates the efficient exchange of this information between CCR participants. The participants are each of the banks and branches of foreign banks carrying on business in the Czech Republic, as well as other persons where so provided in a special legislative act.

Borrowing

Borrowing in general is regulated in large part by the Act No. 89/2012 Coll., Civil Code, as amended. Basic provisions regarding loans and credit can be found in Sections 2390-2400.

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What are common lending structures?

Lending in the Czech Republic can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility). The loan as such can take two basic forms:

- **general loan** – used mainly between professionals in the course of business; or
- **consumer credit** – a special form of loan (governed by a specific regulation – Act No. 257/2016 Coll., on Consumer Credit), with increased protection for consumers.
Loan durations

The duration of a loan can also vary, as follows:

- short-term loan (maximum one-year repayment period);
- medium-term loan (one-to-five-year repayment period);
- long-term loan (more than five-year repayment period); or
- revolving loan – provided for an agreed period of time (usually for one year) with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid.

Loan security

A loan can be secured, unsecured or guaranteed.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable:

- on demand (this is not very common);
- on an amortizing basis (in instalments over the life of the loan); or
- scheduled (usually meaning the loan is repayable in full at maturity).

In the case of consumer credit, there is a special regulation regarding premature repayment of loans which protects consumers against disadvantageous contractual clauses.

What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending backed by mortgages and lending to consumers is a regulated activity. The aim of the regulation is to protect the weaker party to the contract (consumer) and therefore the activity is subject to various legal conditions, which are set out mainly in the Act on Consumer Credit.

Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of Czech law. For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

Trust is a relatively new issue in Czech law, but is starting to be used more frequently not just for descendants (in the context of family trusts) but also as a tool to combat conflicts of interest by transferring some property into a trust.
Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles (with courts also partially mitigating the risks by their powers, eg by lowering an unjust contractual penalty and/or interest rate). The risks can also be reduced by various kinds of security.

Specific types of lending

Lending to consumers is regulated via the Act on Consumer Credit, which includes specific provisions governing loans for housing purposes. Therefore, there is no separate act on mortgages/housing loans in Czech law.

Company in crisis

Pursuant to the Act No. 182/2006 Coll., Insolvency Act (Insolvenní zákon), a company is considered 'in crisis' if it is:

- bankrupt (ie insolvent); or
- under the threat of bankruptcy.

A creditor who, during the crisis of a company, or until the declaration of bankruptcy or the grant of a restructuring permit, provided a loan to such company and at the time of creation of the company's obligation knew, or could have known, of its crisis, may satisfy its claim from the company's assets to the extent attributable to the amount of the loan as authorized by the insolvency administrator. Such creditor has to file his receivable in a standard way, within the deadline stipulated by the insolvency administrator.

Standard form documentation

Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house (each bank uses its own templates for such purpose).

Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments.

In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?
Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to check the constitutional documents of the company giving a guarantee/security to ensure that it is duly established and determine whether there are any requirements to obtain a prior separate resolution of shareholders for such a guarantee or security. All directors must be registered in the Commercial Register and act in accordance with such Commercial Register.

**Insolvency**

A guarantee or security must be granted by the company that has received adequate consideration. If this is not observed, the guarantee/security may be at risk of being contested in the bankruptcy proceedings. A guarantee or security may also be challenged on other grounds relating to insolvency.

**Financial assistance**

For private companies it is possible to provide financial assistance for the purchase of its own shares. This is regulated in the Czech Republic (since 2014) by the Act on Business Corporations and Act on Credit Unions and arises from the Directive No. 2012/30/EU and Regulation No. 575/2013 from the 26 June 2013.

**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees can take a number of forms which are not specifically outlined in law. However, guarantees are most often created in written form.

**Common forms of security**

The basic types of security that can be created under Czech law include:

- a pledge;
- a secured transfer of a right; or
- a promissory note.

Under Czech law it is possible to grant security over all of the assets of a company or individual assets. Granting security will tend to be achieved by way of:

- a pledge over a business share (registered in the commercial register);
- a guarantee;
- a financial guarantee;
- a pledge over the real estate (registered in the land register);
- a pledge over the receivables;
- a pledge over assets which are identifiable and can be controlled by the creditors (such as equipment);
- a security assignment of receivables;
- a secured transfer of right to the property; or
- reservation of ownership of machines (registered in the land register).

In general, a cross-default and/or a cross-collateral can be used for strengthening of the creditor's position as well.
Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee (including a financial guarantee) must be in writing and signed by the guarantor. In the event there is more than one guarantor securing the identical obligations, each one of them is liable for fulfillment of the whole obligations. After the guarantee obligation has been fulfilled by one guarantor then that guarantor has a right of recourse towards the other co-guarantors.

Giving or taking security

Depending on the type of security, a security may have to be granted in writing.

Once granted, the security must be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the security and giving notice of the security to third parties.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Act No. 21/1992 Coll., on Banks (Zákon o bankách) (the regulation of banks, licensing, organization of banks, accounting rules, bank supervision and related fines etc)

Act No. 87/1995 Coll., on Credit Unions (Zákon o spoitelních a úvnních družstvech) (regulating creation of credit unions, crisis management, articles of association, bodies within credit unions, disclosure of information and other related topics)

Act No. 277/2009 Coll., on Insurance (Zákon o pojišovnictví) (regulating conduct in the field of insurance, including supervision, disclosure of information and related topics)

Act No. 15/1998 Coll., on Supervision of Capital Market (Zákon o dohledu v oblasti kapitálového trhu) (primarily regulating the competence of the Czech National Bank to supervise and regulate the capital market in the Czech Republic)

Act No. 256/2004 Coll., on Capital Market Undertakings (Zákon o podnikání na kapitálovém trhu) (regulating investment instruments and investment services, including the investment instruments market generally, the public auction of investment securities, prospectuses and its registration)

Consumer credit

Act No. 257/2016 Coll., on Consumer Credit (Zákon o spotebitelském úvru) (regulating the persons approved to provide consumer credit, its register, rules of conduct, conditions for agreement on consumer credit, supervision etc)

Act No. 284/2009 Coll., on Direct Debit (Zákon o platebním styku) (regulating the persons approved to provide payment services and issue electronic money, payment systems per se, rules and obligations for providing these payment services and related supervision)

Investment funds
Act No. 240/2013 Coll., on Investment Companies and Investment Funds (Zákon o investičních společnostech a investičních fondech) (regulating the positions of the administrator, deposit manager, investment funds, funds of collective investment, funds of qualified investors, investment offers, reporting obligations and supervision of the Czech National Bank)

Corporations

Act No. 90/2012 Coll., on Business Corporations (Zákon o obchodních korporacích) (the primary legislation for business law in the Czech Republic, regulating all kinds of business corporations – limited liability companies, joint-stock companies, companies limited by shares, partnerships etc, as well as their organizational/management arrangements)

Funds and platforms

Act No. 42/1994 Coll., on pension insurance with state contribution (Zákon o penzijním pipojiští se státním píspvkem) (regulating pension funds)

Other key market legislation

Act No. 89/2012 Coll., Civil Code (Obánský zákoník) (the primary legislation for private law in the Czech Republic, governing (among others) all contractual relationships between parties)

Act No. 300/2016 Coll., on Central Evidence of Accounts (Zákon o centrální evidenci út) (regulating the establishment of evidence, terms of use, including details for each account and conditions for entering data into the central register of accounts)

Capital Requirements Regulation (Regulation EU) 575/2013 (capital requirements) (Nářízení o obezatnostních požadavcích na úvěrové instituce) (regulating the rules concerning general requirements in relation to own funds requirements, requirements limiting large exposures, liquidity requirements, reporting requirements and public disclosure requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives) (Nářízení o OTC derivátech, ústředních protistranách a registrech obchodních údajů) (setting out clearing and bilateral risk management requirements for over-the-counter derivative contracts, related reporting requirements and uniform requirements for the performance of activities of central counterparties and trade repositories)

Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse) (Nářízení o zneužívání trhu) (regulating the insider trading, unlawful disclosure of inside information and market manipulation (market abuse) as well as measures to prevent market abuse)

Regulatory authorization

Who are the regulators?

The Czech National Bank (CNB) is the supervisory authority for the financial market in the Czech Republic.

CNB therefore supervises the banking sector, the capital market, the insurance industry, pension funds, credit unions, exchange offices and payment system institutions.

The CNB lays down rules to safeguard the stability of the banking sector, the capital market, the insurance industry and the pension scheme industry. It systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with these rules.

What are the authorization requirements and process?

A company asking for authorization must apply to the Czech National Bank (CNB).

CNB must assess whether the application meets the required threshold conditions within six months of submission of the complete application.
The application fee depends on the type of application and ranges from CZK 5,000 to CZK 200,000.

The regulator will also approve key individuals (senior management) in their roles.

Regulated subjects are listed on the ‘lists of regulated institutions and registered financial market entities’, maintained by the CNB.

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**What are the main ongoing compliance requirements?**

Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance requirement for authorized companies.

Failure to comply with these threshold conditions and other more specific regulatory rules can result in sanctions for companies and other regulated individuals, and loss of authorization status.

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**What are the penalties for failure to be authorized?**

A person undertaking a regulated activity without being authorized or exempt commits an administrative or criminal offence and is liable to sanction.

These are usually administrative sanctions, stipulated for example in Section 36a of the Act on Banks. There could also be penalties up to the amount of CZK 50 million for banks.

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**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

A person must not carry on a regulated finance and investment activity in the Czech Republic unless authorized or exempt.

The activities of the entities that are supervised by the Czech National Bank (CNB) require authorization. As part of its supervision of the financial market, CNB performs supervision over: legal entities and natural persons, other property associations with a designated purpose and groups of persons and property associations with a designated purpose, and is charged with obligations under the Czech laws in the area of banking, capital market, insurance business, pension insurance or pension schemes.

**Consumer credit**

Consumer credit activities, including credit broking, operating an electronic system in relation to lending and entering into a regulated credit agreement as lender are regulated activities.

Unless exempt agreements (see below), these activities can only be offered by firms who are authorized and listed on the ‘lists of regulated institutions and registered financial market entities’.

The available exemptions relate to the nature of the agreement, the lender and the borrower, and the number of repayments to be made. For example, some credit agreements for the purposes of the repeated services or deliveries of goods are exempt agreements.

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**Are there any possible exemptions?**

There are two types of exclusions available when regulated activities may be undertaken without authorization.
General exclusions

Certain persons may carry on a regulated activity without being authorized. For example, in certain cases regulated activities carried on by foreign (EU member-based) persons may be undertaken without authorization.

Specific exclusions

For each type of regulated activity there are a number of specific exemptions that could also apply, such as specific consumer credits.

Do any exchange controls or other restrictions on payments apply?

There are no currency controls in place in the Czech Republic, except for the standard requirement to declare the import of foreign currency to the Czech Republic territory. Also, the anti-money laundering rules and EU payment regulations have to be observed.

What are the rules around financial promotions?

Rules

A financial promotion is a communication of an invitation or inducement to engage in an investment activity made by a person in the course of business.

Since such communications can influence consumers, a person is restricted from communicating such promotions unless they are an authorized person, or the content of the communication has been approved by an authorized person, or the promotion falls within one of the exemptions.

It is both an administrative and a criminal offence for an unauthorized person to communicate a financial promotion.

Exemptions

Exemptions include certain promotions to overseas recipients, provided certain criteria are fulfilled. For example, promotions to overseas recipients are exempt from certain obligations in the case that the fulfillment of the obligation would be irreconcilable with the law of the recipient's country of origin.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are joint-stock companies (akciová společnost abbreviated as 'a.s.' in Czech) and limited liability companies (společnost s ručením omezeným abbreviated as 's.r.o.' in Czech), which are corporations with a separate legal personality and limits on the liability of their members. Banks can be established only as joint-stock companies, as some activities require a certain type of legal entity to be used.

The liability of a company's shareholders can be limited by:

• shares, in which case they are liable to pay for their shares but not the company's debts; or
• guarantee, where they are also liable to pay a certain amount if the company is wound up.

The list of shareholders is kept by the Central Securities Depository. Joint-stock companies can be public or private. A public joint-stock company is one where all or some shares have been accepted for trading on a regulated market situated or operated in any of the State Parties to the Agreement on the European Economic Area. Private joint-stock companies can have a sole shareholder. The company must execute a memorandum of association (or founding deed, where there is a sole shareholder), which includes the company’s articles of association.

Funds

Investment fund is a term which is used for all types of funds, regardless of their legal form. Investment funds can take various legal forms, e.g., a joint-stock company with variable registered capital (SICAV), trust fund, a limited partnership with investment certificates, common fund, cooperative or a private limited company.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A company can conduct lending or investment business in the Czech Republic through a registered establishment (also known as a branch). The foreign entity operating in the Czech Republic through its branch is considered to be a financial institution and generally must deliver to the Czech National Bank (CNB) relevant financial information (on a periodic basis).

Anyone permanently engaged in banking or financial services can be required to obtain the relevant license from the CNB. Institutions granted a banking license in any EU member state can operate in the Czech Republic on the basis of a European passport.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

• operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
• applying technology to leverage and optimize the lending platform and user experience; and
• connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending has started to develop recently in the Czech Republic and is now available to address some forms of traditional bank funding products, such as consumer loans and small and medium-sized enterprises (SME) lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.
Marketplace lending includes peer-to-peer (P2P) type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

**ISSUES FOR STARTUP MARKETPLACE LENDERS**

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt this will typically result in the platform being treated as a securitization for the purposes of the European Union Capital Requirements Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

**Blockchain, smart contracts and cryptocurrencies**

**WHAT IS BLOCKCHAIN?**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the
form of so-called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so-called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
• compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

_Last modified 20 Oct 2017_

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

The Czech National Bank (CNB) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets.

**GENERAL**

A person must not carry on a regulated activity in the Czech Republic unless authorized or exempt (known as the general prohibition). A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in the Czech Republic and it does not fall within any of the available exemptions. Where FinTech products and/or applications involve financial activity which requires regulatory authorization, the firms providing such products and/or applications must be authorized by the CNB.

**Peer-to-peer lending**

A person carries out a regulated activity (requiring authorization by the CNB) if they facilitate lending and borrowing between two individuals or between individuals and businesses in its ordinary course of business.

**Regulation of payment services**

Where a Czech business provides payment services as a regular occupation or business activity in the Czech Republic, it will require authorization by the CNB to become an authorized payment institution under the Payment Services Regulations 2017. Failure to obtain the required authorization is a criminal offence. The regulations implement the European Union Payment Services Directive II.

In order to become authorized by the CNB, a payment services business will need to meet certain criteria, including in relation to its business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

**Application of data protection and consumer laws**
The Czech Act No. 101/2000 Coll. on the Protection of Personal Data (DPA) regulates the processing of personal data within the Czech Republic. The DPA implements the European Data Protection Directive. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the DPA and have certain notification and compliance obligations.

The European General Data Protection Regulation (GDPR) is due to replace the DPA from 25 May 2018 (which will result in a newly drafted Czech Act reflecting the provisions of the GDPR). The GDPR is more prescriptive and restrictive compared to the principles-based DPA, including mandatory notifications where a breach occurs and provides for severe monetary sanctions for breach.

Money laundering regulations

The Czech Act No. 253/2008 Coll. on certain measures against legalization of revenues from criminal acts and financing of terrorism, as amended, gives the CNB responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment. This act also implements the European Union's Fourth Money Laundering Directive.

Generally, where a firm is authorized and supervised by the CNB it will also be authorized and supervised by the CNB for complying with anti-money laundering requirements. Electronic currencies such as bitcoin and cryptocurrencies tend to represent a higher money laundering risk.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an international intermediary platform, such as Crowdcube or Crowdfunder or local Czech platforms such as Hithit, Startovac or Crowder.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

There are various incubators or accelerators in the Czech market which offer support, facilities and funding for startups, often in return for an equity stake. UP21, CreativeDock, Bolt or Air Ventures are the notable startup incubators active on the Czech market.

Venture capital and debt

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible
asset base or long track record needed to attract traditional debt funding from financial institutions.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through VC.

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms such as Zonky, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead interest is paid on the money borrowed.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

The Czech Republic has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) is a popular funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the Prague Stock Exchange.

FinTech companies have also started to access funding by issuing bonds to retail investors as a way of raising more competitive funding.

**CONVERTIBLE BONDS/LOAN NOTES**

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

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**Portfolio sales**

**Loan transfers and portfolio sales**

*What are common ways of buying and selling loans?*

Buying and selling loans is very common and loans are usually transferred separately.

The most important ways of transferring a loan under Czech law are:

- **Assignment of receivables** – The assignment of receivables involves a transfer of rights, but not the related obligations, and can be done without the consent of the debtor. Rights connected with the receivables are transferred together with the main assigned receivable. This way is the most common method of transfer of a loan.

- **Assignment of a contract** – Under Czech Law, the whole contract can be assigned as well. The assignor transfers its rights and
obligations under the contract or part thereof to a third party (assignee) if:

- the transferred party (the other party to the contract) agrees with such assignment;
- the contract is not yet fulfilled; and
- such assignment is not excluded by the nature of the contract itself.

Some contracts can also be assigned by endorsement (rubopis).

- **Novation (with the accession of a third party)** - This is when the existing rights and obligations forming a contract are effectively replaced in full by a new contract. It is a tripartite agreement effecting the transfer of a loan to the third party and is entered into between the transferee and the existing parties.

There are many different forms of these kinds of contracts, however, for more complex transactions a more bespoke form of sale and purchase agreement would tend to be used.

**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan (or portfolio of loans) and related security. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in the Czech Republic varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

**Energy**

The gas and electricity industries in the Czech Republic are privatized, with the generation and distribution and supply services provided
by a number of private sector companies. However, the dominant producer of electricity is EZ, a.s., a joint-stock company with the Czech Republic as the company's largest shareholder with a nearly 70% stake in the registered capital. The relevant private sector companies own the generation and distribution assets.

The Czech Transmission System Operator, a joint-stock company (česká energetická penosová soustava, akciová společnost) controlled by the Ministry of Industry and Trade, is the sole transmission- company and holds an exclusive license granted by the Energy Regulatory Office under the Act No. 453/2000 Coll., Energy Act.

The Energy Regulatory Office (Energetický regulaní úad in Czech) is the principal body with responsibility for regulation of the energy sector in the Czech Republic.

**Telecoms infrastructure**

The telecommunications networks (fixed and mobile) in the Czech Republic are privately owned by a number of service providers. A good example is T-Mobile which is responsible for most of the Czech broadband infrastructure but whose work is heavily regulated by the government. Czech Telecommunication Office (eský telekomunikaní úad) is the regulator of the Czech telecommunications sector. It also has responsibilities for the wireless communications services.

**Transport infrastructure**

**LIGHT RAIL**

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies. For example, The Prague Public Transit Co. Inc. (Dopravní podnik hlavního msta Prahy, akciová společnost) owns the tubes, track and supporting infrastructure in Prague.

**HEAVY RAIL**

The rail market in the Czech Republic is in the early stage of liberalization and its composition (which is complex) involves both public and private entities. The principal elements of the rail sector in the Czech Republic are as follows.

- The owner of the majority of railway lines in the Czech Republic is the state represented by the Railway Infrastructure Administration, which is a state organization (Správa železní dopravní cesty, státní organizace). The Railway Infrastructure Administration is the guarantor of the operability, modernization and development of the railway system of the Czech Republic.
- Public transport authorities, ie central and devolved government bodies and some metropolitan bodies, specify, let and manage operating contracts and give Network Rail a significant proportion of the funding for infrastructure maintenance and enhancement.
- The majority of current passenger services are operated by the state company České dráhy, a joint-stock company (eské dráhy, akciová společnost). In 2011, the privately owned RegioJet became the first company to actively compete with České dráhy on a route. Other private companies own exclusive rights to run services on certain lines.

The rail sector is regulated by the Czech Rail Authority (Dražní úad in Czech).

**ROADS, BRIDGES AND TUNNELS**

A government entity, Road and Motorway Directorate of the Czech Republic, operates, maintains and improves the motorways and major A roads (ie the strategic road network) in the Czech Republic. Road and Motorway Directorate of the Czech Republic is regulated by the Ministry of Transportation and receives funding from the government for investment in the strategic road network (including additional road capacity).

Local roads in the Czech Republic are the responsibility of local authorities. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. In the case of tolled roads, the private sector has taken on roads/crossings on a full concession basis – namely, responsible for the design, build, financing, operation, maintenance and collection of tolls for a number of years with the main revenue stream being the collection of toll revenues from users (rather than any service payments from the public sector).

**AVIATION**

Aviation in the Czech Republic is (for the most part) privatized. As regards airport infrastructure, there are a number of ownership
structures in the Czech Republic market, including public or local government ownership and private ownership. All models are heavily regulated by government and the Civil Aviation Authority (Úad pro civilní letectví) is the aviation regulator in the Czech Republic.

**Other infrastructure**

**SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)**

Typically, these are owned by the public sector. The majority of social infrastructure assets in the Czech Republic are directly financed by the government or by the local authority.

*Education*

The main responsibility for schools stays with the Ministry of Education, Youth and Sport, although more responsibilities were recently delegated to municipal and local authorities. However, existing private schools receive a state contribution towards running costs and are allowed to charge tuition fees. Higher education in the Czech Republic consists of public, state (police and military) and private universities, which also receive a state contribution.

*Hospitals*

Ownership of hospitals is vested in various public sector bodies and more recently also in private owners.

**DEFENSE**

Typically, defense assets are owned by the public sector.

**WASTE**

In the Czech Republic, the waste sector is operated by both public (municipal or local) and private companies and is regulated under the Act No. 185/2001 Coll., Waste Act (Zákon o odpadech).

**WATER**

In the Czech Republic, the water industry is regulated under the Act No. 274/2001 Coll., on Water Supply and Sewerage (Zákon o vodovodech a kanalizácích), but services are largely operated by private companies with exclusive rights for a limited period and a well-defined geographical space.

*Are there special rules for investing in energy and infrastructure?*

**Generally**

There are no specific legal regimes concerning the investment in the fields of energy and infrastructure. The necessary sector-specific regulatory aspects would apply mostly in the phase of planning and implementation itself and not regarding funding.

**Energy**

The energy markets in the Czech Republic have a complex system of arrangements between suppliers, generators, transmission and distribution, which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customer and the Czech Transmission System Operator. These are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move.

Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa. Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.
Telecoms infrastructure

The Czech Act. No. 127/2005 Coll., on Electronic Communications, regulates the telecom sector in a complex way, including definition of relevant parties, their rights and obligations, conditions for regulation, specifics of notification etc.

Transport infrastructure

RAIL

There is an extensive and complex regulatory framework also including the conditions for acquiring a license for provision of transport services which must be taken into consideration in respect of involvement in this sector. As mentioned above, after years of monopoly held by the national rail carrier Czech Railways, currently several train operators are in place. However, the tracks/bridges/some stations are still owned by the state-owned company SŽDC. SŽDC allows track access to all carriers complying with conditions set by the Act. No. 266/1994 Coll., the Railway Act.

The Track Access Conditions correspond to European standards and are equal for all carriers. SŽDC concludes a contract for rail transport operation with a carrier who has met conditions of the track access. For more details see Network Statement on national and regional rail issued by SŽDC.

The basic conditions for access to the railway infrastructure include to:

- be registered in the Company Register;
- hold a valid license to operate rail transport;
- hold a valid certificate of a carrier;
- effect liability insurance for damage incurred by the rail transport operation;
- conclude a rail transport operation contract with the rail operator; and
- be allocated track capacity.

For more details see Railway Act No. 266/1994 Coll., as amended and the Network Statement on national and regional rail issued by SŽDC.

ROADS

Administration of roads is in the hands of the state, municipal or other public sector entities. The relevant public sector entity is also responsible for carrying out the maintenance of the roads. However, such duties may be delegated to the private sector partners, based on the relevant procurement rules. With respect to the highways, an example of this is the private company Kapsch, which has installed the toll gates on highways and is in charge of collecting toll-fees in the Czech Republic.

What is the applicable procurement process?

Public procurement in the Czech Republic is regulated by Act No. 134/2016 Coll., on Public Procurement, as amended (Zákon o zadávání veřejných zakázek). This Act has implemented:

- Directive 2014/24/EU on public procurement (and repeals Directive 2004/18/EC); and

The following contracts are regulated under Czech law:

- below-the-threshold public contracts/concessions;
- small-scale public contracts/concessions;
- public contracts in the water, energy, transport and postal services sectors; and
Procurement processes

The various types of procurement processes regulated by the Czech Act on Public Procurement are as follows.

SIMPLIFIED BELOW-THRESHOLD PROCEDURE

A contracting authority announces to an unlimited number of suppliers its intention to award a public contract. Call for tenders can be sent directly to a tenderer, in which case the call has to be sent to at least five tenderers. There are shorter periods for application for and execution of the contract in this procedure.

OPEN PROCEDURE

A contracting authority announces to an unlimited number of suppliers its intention to award a public contract. The open procedure is a call for tenders and proof of qualification.

RESTRICTED PROCEDURE

The contracting authority announces to an unlimited number of suppliers its intention to award a public contract in the tender procedure. It then invites the suppliers to submit a request to participate in the restricted procedure and to send a proof of qualification. The call for tenders is sent directly to the suppliers selected by the contracting authority.

NEGOTIATED PROCEDURE WITH PRIOR PUBLICATION

The contracting authority announces its intention to award a public contract. The announcement is an invitation to apply for participation in the negotiated procedure with publication and to demonstrate its skills. Invited bidders submit a tender.

NEGOTIATED PROCEDURE WITHOUT PRIOR PUBLICATION

The contracting authority announces to candidates or a limited number of applicants its intention to award a public contract by tender. After concluding the contract, the contracting authority is obliged to issue the contract award notice.

COMPETITIVE DIALOGUE

The contracting authority announces to an unlimited number of suppliers its intention to award a public contract. The authority invites suitable suppliers to dialogue with the authority to develop the most suitable solution in respect of the public contract in question and all conditions needed to find the best way to perform the contract.

INNOVATION PARTNERSHIP

In cases where there are no technologies or methods readily available in the market, the contracting authority announces to an unlimited number of suppliers its intention to award a public contract involving an innovation partnership. The authority then discusses the most suitable process with all suitable suppliers.

CONCESSION PROCEDURE

The contracting authority announces to an unlimited number of suppliers its intention to award a public contract. This procedure is used in cases when the authority wishes to award a special concession from the authority to the supplier, typically construction work.

PROCEDURE TO AWARD A PUBLIC CONTRACT IN THE SIMPLIFIED REGIME

The contracting authority announces to an unlimited number of suppliers its intention to award a public contract in simplified regime for special services such as social services or low cost services. The authority determines the procedure it wishes to use and can determine special tender criteria according to the nature of the service needed.

The key principles are that contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality (especially within the EU) and that all potential bidders are treated equally.
Investing in energy and infrastructure

Public procurement is relevant where the Czech government, or a branch of it, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset.

The relevant procurement legislation applies to certain public bodies including central government departments, local and municipal authorities, public-benefit corporations, Czech National Bank, various non-governmental public interest-purposed bodies or any entity, which is controlled by those previously mentioned bodies. A regulated procurement is required where certain financial thresholds are met. In the case of most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

What are the most common forms of funding / investing in energy and infrastructure?

Funding

The common forms of funding in energy and infrastructure include:

- loans made on a corporate-finance basis;
- loans made on a project-finance basis;
- bond finance (this was used for example by the private rail operator Leo Express);
- mezzanine debt; and
- refinancing of the debt in operational projects.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Czech National Bank considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

What regulatory penalties may apply?

Please note that only the most serious offences and related penalties are listed below.

The Act on Banks establishes several contraventions and regulatory offences for violating the rules:

- Under Section 36a, if a natural person undertakes a regulated activity without the permission of the Czech National Bank, fails to fulfill a duty of informing the Czech National Bank or accepts a deposit contrary to the rules, that person may be fined up to twice the
amount of any unauthorized benefit (dvojnásobku výše neoprávněného prospěchu) or CZK 130 million.

• Under Section 36c, if a legal entity or a natural person-entrepreneur undertakes a regulated activity without the permission of the Czech National Bank, fails to fulfill a duty of informing the Czech National Bank or accepts a deposit contrary to the rules, that person may be fined up to twice the amount of any unauthorized benefit or CZK 130 million.

• Under Section 36e, if a bank fails to fulfill a duty of informing the Czech National Bank or fails to fulfill a duty in accordance with Article 99 of the Regulation (EU) 575/2013, that bank may be fined up to twice the amount of any unauthorized benefit or 10% of its annual turnover.

The Act on Credit Unions establishes several contraventions and regulatory offences for violating the rules:

• Under Section 27a, if a natural person undertakes a regulated activity without the permission of the Czech National Bank or takes over a Credit Union without previous permission of the Czech National Bank, that person may be fined up to twice the amount of any unauthorized benefit or CZK 130 million.

• Under Section 27b, if a credit union fails to fulfill a duty of informing the Czech National Bank or violates the rules relating to the determination of capital, that Credit Union may be fined up to twice the amount of any unauthorized benefit or 10% of its annual turnover.

• Under Section 27c, if a legal entity or a natural person-entrepreneur uses the term credit union contrary to the rules, initiates an activity without permission, fails to fulfill a duty of informing the Czech National Bank or takes over a Credit Union without the previous permission of the Czech National Bank, that person may be fined up to twice the amount of any unauthorized benefit, CZK 130 million or 10% of its annual turnover.

The Act on Insurance establishes several contraventions and regulatory offences for violating the rules:

• Under Section 119, if a natural person provides false information in its application or intends to increase its participation in an Insurance or Reinsurance Company and become a controlling entity without the previous permission of the Czech National Bank, that person may be fined up to CZK 1 million.

• Under Section 120, if a legal entity or a natural person-entrepreneur violates the secrecy, provides false information in its application or intends to increase its participation in an insurance or reinsurance company and becomes a controlling entity without the previous permission of the Czech National Bank, that insurance or reinsurance company and/or its controlling entity may be fined up to CZK 10 million.

• Under Section 120, if an insurance or reinsurance company undertakes an insurance or reinsurance activity without permission of the Czech National Bank or appoints a person who is untrustworthy or unprofessional to the key functions of the company, the Insurance or Reinsurance Company may be fined up to CZK 50 million.

The Act on Capital Market Undertakings establishes several contraventions and regulatory offences for violating the rules:

• Under Section 157, if an investment firm fails to fulfill a duty of informing the Czech National Bank in accordance with Article 99 of the Regulation (EU) 575/2013, the Investment firm may be fined up to twice the amount of any unauthorized benefit or 10% of its annual turnover.

• Under Section 158, if a regulated market operator fails to fulfill a duty of informing the Czech National Bank or violates a restriction or prohibition issued by the Czech National Bank, the regulated market operator may be fined up to CZK 20 million.

• Under Section 159, if a multilateral system operator fails to fulfill a duty of informing the Czech National Bank or violates a restriction or prohibition issued by the Czech National Bank, the Multilateral System Operator may be fined up to CZK 20 million.

• Under Section 161, if a central securities depository fails to fulfill a duty of informing the Czech National Bank in accordance with Article 27 of the Regulation (EU) 575/2013 or fails to fulfill a duty of informing the Czech National Bank in accordance with Article 40 of the Regulation (EU) 575/2013, the Multilateral System Operator may be fined up to twice the amount of any unauthorized benefit, CZK 550 million or 10% of its annual turnover.

• Under Section 162, if an issuer fails to publish an annual report, a biannual report, the issuer may be fined up to twice the amount of any unauthorized benefit, CZK 300 million or 5% of its annual turnover.

• Under Section 164, if a legal entity or a natural person-entrepreneur fails to fulfill a duty of informing the Czech National Bank in accordance with Article 30 of the Regulation (EU) 575/2013 or fails to fulfill a duty of informing the Czech National Bank in accordance
with Article 53 of the Regulation (EU) 575/2013, that person may be fined up to twice the amount of any unauthorized benefit, CZK 550 million or 10% of its annual turnover.

- Under Section 166, if a natural person fails to fulfill a duty of informing the Czech National Bank, the person may be fined up to twice the amount of any unauthorized benefit or CZK 60 million.

The Act on Supervision on the Capital Market establishes several Contraventions and Regulatory offences for violating the rules:

- Under Section 9b, if a legal entity or a natural person-entrepreneur fails to fulfill any duties connected with the acquisition of shares in a joint-stock company or acquisition by a controlled person, that person may be fined up to CZK 50 million.

- Under Section 9c, if a natural person fails to fulfill any duties connected with the acquisition of shares in a joint-stock company or acquisition by a controlled person, that person may be fined up to CZK 25 million.

**What criminal penalties may apply?**

In accordance with the Act No. 40/2009 Coll., Penal Code (Trestní zákoník), the criminal justice institutions have powers to impose criminal penalties in certain (finance and investment related) cases, including:

- **under Section 251** – criminal offence of unauthorized entrepreneurial activities, which may lead to up to eight years of imprisonment, monetary penalty, punishment by disqualification or the dissolution of a legal entity;

- **under Section 248** – criminal offence of violation of Regulations on Rules of Competition (eg misleading advertising or misleading labelling of goods and services), which may lead to up to eight years of imprisonment, monetary penalty, punishment by disqualification, forfeiture of items or the dissolution of a legal entity; and

- **under Section 216** – criminal offence of money laundering which may lead to up to eight years of imprisonment, monetary penalty, punishment by disqualification, forfeiture of property or the dissolution of a legal entity.

According to Sections 16, 17 and 18 of Act No. 418/2011 Coll., on the Criminal Liability of Legal Entities and Proceedings against them (Zákon o trestní odpovdnosti právnických osob a ízení proti nim), where the punished legal entity be a bank, credit union, insurance and reinsurance company, investment firm, pension fund, central securities depository, electronic money institution, payment institution or regulated market operator, a statement of the Czech National Bank is required.

**Tax**

**Tax issues**

**Are stamp, registration, transfer or other similar taxes applicable?**

**Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?**

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan. Certain administrative fees may, however, apply on the transfer or assignment of a debt under a loan.

**Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

No. However, individual registrations of these transactions may require the payment of administrative fees.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?**
No stamp, registration or similar taxes are payable on the issue, transfer or assignment of debt securities. Various fees may apply.

Last modified 20 Oct 2017

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

No.

Last modified 20 Oct 2017

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Yes, withholding tax is imposed on interest payments under a loan.

If so:

What is the rate of withholding?

The rate of withholding tax on interest payments to both lenders resident in the Czech Republic and lenders not resident in the Czech Republic is, generally, 15%. A higher rate of 35% is applicable in some cases where interest payments are made to certain lenders resident in jurisdictions outside of the EU or resident in countries that are not party to a double tax treaty with the Czech Republic.

What are the key exemptions?

Interest payments to banks or to other financial institutions resident in the Czech Republic are not subject to withholding tax.

An exemption from the application of withholding tax on interest payments may be applicable, in whole or in part, under the terms of a double tax treaty entered into by the Czech Republic with the country of residence of the lender, provided that the requisite conditions are met.

An exemption may also be available under the EU Interest and Royalties Directive, as implemented under the domestic law of the Czech Republic.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

Double tax treaties and relevant EU Directives apply to any payments of interest from Czech Republic to lenders resident in other countries.

Would the same analysis apply to interest payments under a debt security (eg a bond)?
Yes.

Key contacts

Miroslav Dubovský
Partner
DLA Piper Prague LLP
miroslav.dubovsky@dlapiper.com
T: +420 222 817 500
Finland

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Finnish and EU law. The Securities Markets Act regulates offering and selling debt securities in Finland.

Unless exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Finland or to request that they are admitted to trading on a regulated market operating in Finland unless a prospectus, that the Finnish Financial Supervisory Authority has approved, has been made available to the public.

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What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Finland are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in Finland. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (i.e. debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

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What are the differences between offering debt securities to institutional/professional or other investors?

The Prospectus Regulation is implemented in Finland by Chapter 3 of the Securities Markets Act and the Decree of the Ministry of Finance on the Prospectus referred to in Chapter 3–5 of the Securities Markets Act. The Act does not make a distinction between professional and other investors for the purposes of its disclosure requirements, however, different methods of disclosure apply. In relation to the obligation to prepare a prospectus, see the following answers in Issuing and investing in debt securities.

According to the Act, anyone who offers securities to the public and seeks admission to trading on a regulated market of a security shall publish a prospectus of the securities prior to the entry into force of the offer or the admission to trading on a regulated market of a security and keep it available to the public while the offer is open.

When is it necessary to prepare a prospectus?

Under the Securities Markets Act, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer would not be deemed to have been made to the public if it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per European Economic Area state or where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market.

According to Chapter 3, Section 2, however, a prospectus need not be published, for example, if the notification procedure as provided for in article 25 of the Prospectus Regulation is not applied to the offering, and the securities are offered in the EEA-area during a period of twelve months in an amount with a total consideration of a maximum €8 million. In addition it is required that the issuer publishes and delivers to the Finnish Financial Supervisory Authority a Key Investor Information Document, in cases where the securities are offered in an amount with total consideration of less than €1 million calculated in the EEA area over a period of 12 months.

Furthermore, a prospectus need not to be published, if the securities are offered:

- solely to qualified investors;
- calculated per each EEA member state, to fewer than 150 investors;
- to be acquired for a total consideration of at least €100,000 per investor and per offer or in units with a denomination or consideration of at least €100,000; or
- in an amount with a total consideration of less than €2.5 million calculated in the EEA over a period of 12 months.

What are the main exchanges available?

Nasdaq Helsinki is a regulated market licensed in Finland. Nasdaq First North is a market for smaller companies and growth companies.

Trading at Nasdaq Helsinki is governed by the Issuer Rules, the Member Rules and the Warrant Rulebook. Nasdaq First North is an MTF that is subject to separate rules.

Issuers on the Nasdaq Helsinki market are subject to the requirements of a number of EU Directives, including the Market Abuse Directive (implemented in Finland by several Acts, including the Markets Securities Act and the Act on Trading in Financial Instruments) and the Transparency Directive (implemented in Finland by the Markets Securities Act).

Is there a private placement market?
There is no definition of a private placement in Finnish legislation, but it is generally understood to mean an offering of securities that are exempted from, in case of transferable securities, the requirement to publish a prospectus. In our opinion, there is a private placement market in Finland.

Private placement may be qualified as offering of investment services under the Finnish Investment Services Act. The general provisions of Chapter 1 of the Act governing disclosure obligation and practices are applicable to all securities offerings (also where there is no obligation to publish a prospectus). The Act does not set any specific requirements as to the form of document with regard to a prospectus exempted offering, customarily a private placement memorandum/investor presentation is provided.

**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both administrative and criminal liability under Finnish law.

**Investing in debt securities**

The most significant risk related to debt securities is the issuer's repayment capacity, or the risk as to whether the issuer is able to perform its obligations on the maturity date (or other payment dates), that is, to repay the nominal capital and return to the investors. In order to enable the assessment of the issuer's repayment capacity, the bond prospectus or base prospectus describes the issuer's financial position and risks factors related to debt securities.

**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**

**Generally**

Establishing a fund, offering fund securities and operating a fund, amongst other things, are regulated activities under the Act on Mutual Funds (the MFA). The MFA governs common funds, which are Undertakings for Collective Investments in Transferable Securities (UCITS) funds as provided in the Undertakings for Collective Investments in Transferable Securities Directive.

Mutual fund activity is defined in the MFA as raising of funds from the public for their joint investment and the investment thereof mainly in financial instruments as well as the management of a common fund and the marketing of units in accordance with the UCITS Directive and the MFA.

Only a management company authorized as provided in the MFA may establish one or more common fund (UCITS fund) and carry out mutual fund activities.

Only a management company authorized or registered as provided in the Act on Alternative Investment Fund Managers may establish one or more special common fund or other alternative investment fund.

Custodial activity of a common fund, a special common fund or other alternative fund may only be carried out by a custodian, which has an authorization for the custodial activity.
What are common fund structures?

There are two main categories of funds: Undertakings for Collective Investments in Transferable Securities (UCITS) funds (common funds) and non-UCITS funds (special common funds and other alternative investment funds).

Risk in a special common fund does not need to be diversified as broadly as with UCITS funds. A special common fund is also an alternative investment fund as provided in the Act on Alternative Investment Fund Managers.

Common (UCITS) funds

Common funds are regulated by the Act on Mutual Funds, implementing the UCITS directive, which specifies the eligible investment types and the required diversification between investments in Chapter 11 of the Act. The Finnish Financial Supervisory Authority (FIN-FSA) approves the fund rules.

Special common (Non-UCITS) funds and other alternative investment funds

Special common funds are non-UCITS, alternative investment funds deviating from the principle of diversification of risk pursuant to Chapter 13 of the Mutual Funds Act. If the units of a special mutual fund shall be offered to non-professional clients, the risk must be diversified (but to a lesser amount than in an UCITS fund) and the rules of the fund must indicate the deviations from the principles of Chapter 13 of the MFA. The rules regulating the subscription and redemption of the units in a special common fund may also deviate from those of a UCITS fund. The name of the fund must indicate that it is a non-UCITS fund. The Finnish Financial Supervisory Authority has to be notified of the rules of a special common fund.

The investment operations of other alternative investment funds are not regulated, but the Act on Alternative Investment Fund Managers specifies the information that the funds must provide on themselves. Subject to certain exceptions as to e.g. family offices and business angel investors, alternative investment funds may be marketed to non-professional investors only, if the fund manager has been authorized and rules and a key investor information document (KIID) have been prepared for the fund. The FIN-FSA does not approve the rules of alternative investment funds.

What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Undertakings for Collective Investments in Transferable Securities (UCITS) funds must be open for all investors and are therefore subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depositary arrangements for assets, investment and borrowing powers specifications, concentration requirements and other matters. The information to be provided to investors in an UCITS fund is regulated by Mutual Funds Ac. The Act does not make a distinction between non-professional and professional/institutional investors in an UCITS fund.

Non-UCITS funds can restrict the scope of eligible investors in their fund rules. However, if the units of a special mutual fund shall be offered to non-professional investors, the risk must be diversified (but to a lesser amount than in an UCITS fund) and the rules of the fund must indicate the deviations from the principles of Chapter 13 of the MFA. As a main rule, a special mutual fund shall have a minimum of ten investors.

Subject to certain exceptions as to e.g. family offices and business angel investors, the units in an alternative investment fund may be marketed to non-professional investors only if the fund manager has been authorized, the rules and a key investor information document (KIID) have been prepared for the fund and all the required documents and information has been provided to the FIN-FSA. The legal forms and domiciles of alternative investment funds (AIFs) allowed to be offered to non-professional investors is restricted. Further, the AIF units may not be offered to non-professional investors if the subscription obligates to additional investments and any such obligations are non-binding on a non-professional investor.

Professional investors may waive their legal right to receive information from the alternative investment fund manager in writing. As mentioned, if the AIF units are only offered to professional investors the key investor information document (KIID) does not need to be prepared.

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When offering and marketing the funds to consumers, also the provisions of the Finnish Consumer Protection Act shall also be adhered to.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

It can be noted that as a main rule, the fund documentation shall be drafted in Finnish or Swedish if no other language is approved by FIN-FSA, when the fund is marketed to non-professional investors.

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**Managing and marketing debt / hedge funds**

**Are there any restrictions on marketing a fund?**

Several acts regulate marketing a fund; the Mutual Funds Act as well as the Act on Alternative Investment Managers regulate specifically the marketing of funds. Further, the Consumer Protection Act regulates all marketing directed at consumers and the Unfair Business Practices Act regulates marketing in general. All these regulations shall be taken into account when marketing a fund, as applicable.

The Finnish Financial Supervisory Authority (FIN-FSA) has also given instructions and regulations on marketing funds. These instructions contain, amongst other things, information on:

- what kind of language shall be used in marketing (a non-professional investor should be able to understand the language that is used);
- how comparisons between different funds shall be made; and
- how the funds shall be identified in marketing.

**Undertakings for Collective Investments in Transferable Securities (UCITS) funds**

The management company may not begin to market the units in a common (UCITS) fund to the public or receive funds from public into the common fund before the fund rules have been confirmed by the FIN-FSA.

A UCITS fund manager from another EEA country may market units in such fund in Finland if the competent authorities of its home Member State have submitted to the FIN-FSA a notification of the commencement of marketing.

**Special Common Funds and other alternative investment funds (AIFs)**

The management company may not market units in a special common fund or receive money to the fund before the board of directors of the fund management company has approved the rules and the FIN-FSA has been notified of the rules and the commencement of marketing of the fund.

The alternative investment fund manager may market the units in an AIF managed by after a notification to the FIN-FSA as regards the AIF and receipt of a notification from the FIN-FSA regarding the same. The same applies also to the marketing by an investment firm of the AIF units. However, subject to certain exceptions as to e.g. family offices and business angel investors, the units in an AIF may be marketed to non-professional investors in Finland only if the fund manager has been authorized, the rules and a key investor information document (KIID) have been prepared for the fund and all the required documents and information has been provided to the FIN-FSA.

The manager of an AIF from another EEA country or from a third country may market its units in Finland when it has submitted to the FIN-FSA a notification of the commencement of marketing and received a notification from the FIN-FSA regarding the same.

**Reverse solicitation and the definition of ‘marketing’**
‘Marketing’ is not defined in the Act on Alternative Investment Fund Managers. In the relevant government Bill, it has been viewed that in order to qualify an action as ‘marketing’, it has to be made by the alternative investment fund manager (AIFM) or on its behalf and it has to contain the offering of the units in an alternative investment fund managed by it. The offering can be direct or indirect.

It has been held in the government Bill that an action which does not include offering of units cannot be seen as marketing and, consequently, actions taken by the AIFM or on its behalf to map the interest of investors to invest in a certain type of investment (‘soft circling’) would not be qualified as marketing. Further, actions directed towards professional investors, which do not aim to a binding subscription to the fund units, should not be labelled as marketing in the context of the Act. These can include for example road shows initiated by the AIFM, provided such events do not include a specific sale or purchase offer of the AIF units (although comparable events initiated by issuers or investment service providers may qualify as marketing of securities). In addition, reverse soliciting i.e. the investor contacting the AIFM and the AIFM providing information on different investment opportunities, should not be seen as marketing.

Provision of offering documents related to an established fund managed by the AIFM is considered as negotiations on the terms of an investment and subject to prior FIN-FSA notification. Provision of various agreements related to a fund which has not been established yet does not, however, require that the AIFM must adhere to the provisions of law regarding marketing. When a binding subscription is made, the AIFM must be able to demonstrate that it has adhered to the marketing provisions of the AIFM Act and duly made a notification to the FIN-FSA.

**Are there any restrictions on managing a fund?**

Fund management is a regulated activity in Finland under the Mutual Funds Act. Managing a fund is subject to authorization granted by the Finnish Financial Supervisory Authority (FIN-FSA) that also supervises fund management companies. Under the Mutual Funds Act, each mutual fund must be managed by an authorized fund management company.

A fund management company must separate fund assets from its own assets by assigning the former to a custodian. Fund management companies may engage only in the fund activity and other essentially related business (as defined in the applicable legislation), if doing so does not materially conflict with the interests of holders of mutual fund shares. In addition, fund management companies may provide asset management services and investment advice as well as safekeeping and administration of shares in mutual funds and undertakings for collective investment in transferable securities (UCITS).

Fund management companies must have sufficient financial strength to operate effectively and must not be closely associated with companies or individuals that could prevent effective supervision of the management company. A management company shall carry out fund activity independently, in compliance with the applicable legislation, and with care and expertise and in the best interests of the common fund and its unitholders.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Act on Alternative Investment Fund. Under the Act, an AIF may only be managed by and AIFM authorized by the FIN-FSA. However, some AIFM can be exempted from full regulation on certain grounds, including managing assets under €500 million where assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers must still register with the FIN-FSA and are subject to limited reporting.

**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

Under the Act on Investment Services, investment services (including derivatives contracts) may only be offered by authorized entities, unless a specific exemption applies.

There are no general restrictions in relation to the counterparty, however, certain entity specific restrictions may apply (for example the Mutual Funds Act provides restriction on mutual funds when entering into derivatives agreement).

The European Market Infrastructure Regulation (EMIR) applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and
What are common types of derivatives?

The main types of derivatives contracts used in Finland include *inter alia*:

- swaps (such as interest rate and currency swaps);
- forwards;
- options;
- futures; and
- commodity-linked derivatives.

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying assets are:

- equity;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought, in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen, and continues to see, the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is a regulated activity in relation to lending to consumers. The Consumer Protection Act regulates consumer credits and the Finnish Competition and Consumer Authority supervises lending to consumers.

Consumer loans are subject to a range of regulatory requirements. For example, there are particular restrictions around:
• how the loans are marketed;
• how to deal with borrowers who fall behind with their payments; and
• how payments may be claimed from the consumers.

Borrowing

Borrowing is generally not regulated in Finland. However, certain borrowers may benefit from specific protection provided to them under Finnish law (for example consumers).

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What are common lending structures?

Lending in Finland can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, e.g. term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

• a term loan, provided for an agreed period of time but with a short availability period;
• a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
• an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
• a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed.

Loan commitment

A loan can be:

• committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can be paid back in instalments of the same size consisting of a loan repayment portion and an interest portion. The size of the monthly instalment changes in line with changes in interest rates, but the loan period remains unchanged (annuity loan).

It can also be paid back in instalments of the same size consisting of a loan repayment portion and an interest portion. The size of the
monthly instalment remains unchanged when interest rates change, but the loan period changes (fixed instalment loan).

It can also be paid back in instalments consisting of a fixed loan repayment portion and an interest portion that changes as interest rates change. When interest rates change, the size of the monthly instalment changes, but the loan period remains unchanged (fixed period loan).

It can also be paid back in one instalment consisting of the whole loan amount at the end of the loan period, and during the loan period only interest payment shall be made.

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to legal persons is subject to less regulatory oversight and so less burdensome from a compliance perspective. It is mainly a matter of contract law.

The Consumer Protection Act (especially Chapters 7 and 7a) regulates lending to consumers and the provisions in the Act are mandatory.

_Last modified 26 Nov 2019_

**Do the laws recognize the principles of agency and trusts?**

Trusts are generally not recognized in Finland however, under the quite recent Act on Detecting and Preventing Money Laundering and Terrorist Financing, trust, as they are defined in Article 3, Section 7 of the Directive (EU) 2015/849, are recognized as legal entities for the purposes of the said Act.

The principle of agency is recognized in Finland and in accordance with the Act on Agent of Bondholders, it is possible to appoint an agent to act on behalf of other parties and to hold rights and other assets for the lenders or secured parties.

_Last modified 26 Nov 2019_

**Are there any other notable risks or issues around lending?**

**Generally**

Loan agreements and other finance documents are subject to general contractual principles. Consumer clients must be taken into consideration because the regulations regarding consumers are mandatory.

**Specific types of lending**

For instance, providing mortgages to consumers is subject to mandatory regulations. The Mortgage Credit Directive, which is implemented in Finland through chapters 6, 7 and 7a of the Consumer Protection Act, imposes a number of requirements on lenders. These requirements include, amongst other things, the lender's need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

**Standard form documentation**

Most Finnish syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA). These are often governed under English law, however. Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house and be governed by Finnish law.

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Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU’s Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions. It has been implemented in Finland through the Act on Resolution of Credit Institutions and Investment Firms (laki luottolaitosten ja sijoituspalvelu wymysten kriisin ratkaisusta) and the Act on the Financial Stability Authority (laki rahoitusvakausviranomaisesta).

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail-in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. ‘Bail-in’ describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Under Finnish law, a security interest shall be validly and bindingly given and established, provided that the following four requirements have been met:

- a pledge agreement between the parties;
- competence to give the pledge (i.e. security);
- an underlying obligation which is to be secured by the security; and
- the applicable perfection measures having been taken.

From these requirements, we would especially highlight requirements the second and last (ie competence and perfection measures) as worthy of consideration. When these four requirements are met, the pledge constitutes a valid and binding obligation of the party giving the security.

The following points should also be considered.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors’ powers that would be preventative. In some cases, it would also be advisable to request a copy of the decision of the board of directors (or an extract of it), in which it was decided to enter into the transaction in question. If it is not within the company’s capacity to enter into a security agreement, but such an agreement is entered into regardless, the agreement shall be binding unless the counterparty knew, or it ought to have known, that the signatories were acting against their capacity. It should also be noted, that Section 1 of Chapter 13 of the Companies Act states how a limited liability company may distribute it assets. According to this section, any distribution of assets which is contrary to the provisions of the Companies Act, constitutes unlawful distribution of assets. Under the Companies Act, distribution of assets includes all transactions which might affect the company’s liquidity. Further, under the Companies Act, a company must always ensure that entering into any transaction is in the best interest of the company.

Insolvency

In insolvency proceedings any security given may be set-aside if the provisions of the Recovery Act are met. Under Section 14 of the Recovery Act, a security may be set-aside if:
• the security was given for an already existing debt obligation; or
• if the relevant perfection measures were not taken without undue delay.

It is further required under both the above-mentioned situations that the security was given within three months prior to the beginning of the insolvency proceedings (or within two years for connected parties). It should be noted that any security given (and the related agreements) may also be subject to proceedings under alternative provisions of the Recovery Act to those listed here.

**Financial assistance**

Under the Companies Act it is unlawful for a limited liability company, including both private and public companies to provide financial assistance for the purchase of its own (or its holding company's) shares. Financial assistance in this context would include giving a guarantee or security in connection with the share purchase.

**Natural person**

If security or a guarantee is given by a natural person, there are some specific mandatory requirements which need to be taken into consideration. For example, under applicable legislation, the natural person must be given sufficient information about the pledge or the guarantee by the beneficiary.

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**What are common types of guarantees and security?**

**Common forms of guarantees**

 Guarantees may be given for one's own debt or for someone else's. In both cases the guarantees may be either performance guarantees or payment guarantees. Performance guarantees guarantee the performance of the underlying obligations of the debtor. Such guarantees are typically given by a parent company for the performance obligations of its subsidiary. Payment guarantees on the other hand cover the payment obligations of the debtor rather than any contractual performance obligation. The specific terms and conditions applicable to guarantees are determined on a case by case basis.

**Common forms of security**

The most common forms of securities granted by a company of its assets are:

• a mortgage over real estate;
• a pledge over assets which are identifiable and can be controlled by the creditors (such as equipment and vehicles);
• a floating charge over the fluctuating assets of the company (Yrityskiinnitys); and
• a pledge of receivables (such as rental income) and bank accounts.

*Last modified 26 Nov 2019*

**Are there any other notable risks or issues around giving and taking guarantees and security?**

**Giving or taking guarantees**

The most notable risks are related to guarantees given by natural persons.

If a guarantee is given by a Finnish limited liability company for liabilities of a third party then the guarantee is subject to the condition that sufficient corporate benefit, as such concept is applicable under the Limited Liability Companies Act, is given to the guarantor or pledgor, and the requirement set out in Section 13:2 of the Companies Act that no distribution of funds should lead to insolvency will apply. The
existence of corporate benefit and the fulfilment of the requirement in Section 13:2 are ultimately questions of fact. Should the above referenced requirements not be fulfilled, any guarantee or other security provided for obligations owed by other parties, may be limited and funds or proceeds received may have to be returned to the guarantor.

**Giving or taking security**

A pledge is only valid and binding if it meets certain prerequisites (for more information, see Giving and taking guarantees and security – restrictions). Of these prerequisites, particular consideration should be had to perfection measures, as if these are not undertaken in accordance with the applicable law, the pledge might not be binding to third parties and it is also more likely to be subject to proceedings to have the pledge set aside. The perfection measures differ depending on the nature of the pledged assets (for example, with real estate mortgages the pledge has to be notified to the register at the Finnish land registry and with shares the pledge has to be written in the share and shareholder’s register and relevant share certificates must be given to the beneficiary).

In addition, we would recommend that pledge and guarantee agreements are made in written form signed by both parties. While this is not a mandatory requirement under Finnish law it is recommended for good order.

In addition, any security or guarantee may be subject to measures to have such guarantee or security set-aside under the Recovery Act.

**Financial regulation**

**Law and regulation**

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

- Securities Markets Act (746/2012, Arvopaperimarkkinalaki)
- Unfair Business Practices Act (1061/1978, Laki sopimattomasta menettelystä elinkeinotoiminnassa)
- Act on Trading in Financial Instruments (1070/2017, Laki kaupankäynnistä rahoituskäytännöillä)
- Act on Security Accounts (750/2012, Laki arvopaperitileistä)
- Act on Detecting and Preventing Money Laundering and Terrorist Financing (444/2017, Laki rahanpesun ja terrorismin rahoittamisen estämisestä ja selvittämisestä)
- The Act on Finnish Financial Supervisory Authority (878/2008, Laki Finanssivalvonnasta)

**Consumer credit**

- Act on Consumer Mortgage Brokers (852/2016, Laki asunto-omaisuuteen liittyvien kuluttajaluottojen välittäjistä)
- Consumer Protection Act (38/1978, Kuluttajansuojalaki)
- Act on Registration of Certain Loan Providers and Credit Brokers (853/2016, Laki eräiden luotonantajien ja luotonvälittäjien rekisteröinnistä)

**Credit institutions**

- Act on Credit Institutions (610/2014, Laki luottoaloitostainminnasta)
- Payment Services Act (290/2010, Maksupalvelulaki)
- Act on Payment Institutions (297/2010, Maksulaitoslaki)
Act on Foreign Payment Institutions' Actions in Finland (298/2010, Laki ulkomaisen maksulaitoksen toiminnasta Suomessa)

Act of Registration of Entities Undertaking Debt Collection (411/2018, Laki perintätoiminnan harjoittajien rekisteröinnistä)

Act on Agent of Bondholders (574/2017, Laki joukkolainanhaltijoiden edustajasta)

**Corporations**

Limited Liability Companies Act (624/2006, Osakeyhtiölaki)

Partnerships Act (389/1988, Laki avoimesta yhtiöstä ja kommandiittiyhtiöstä)

**Funds, platforms and investing**

Act on Crowd Funding (734/2016, Joukkorahoituslaki)

Act on Investment Services (747/2012, Sijoituspalvelulaki)

Act on Alternative Fund Managers (162/2014, Laki vaihtoehtorahastojen hoitajista)

Act on Mutual Fund (213/2019, Sijoitusrahastolaki)

**Other key market legislation**

Bank Recovery and Resolution Directive (2014/59/EU), implemented by the Act on Resolution of Credit Institutions and Investment Firms and by the Act on the Financial Stability Authority

Markets in Financial Instruments Directive (2004/39/EC), implemented by several national acts, mainly however, by the Act on Investment Services and by the Securities Markets Act

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)

Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)

**Regulatory authorization**

**Who are the regulators?**

Finanssivalvonta, or the Finnish Financial Supervisory Authority (FIN-FSA), is the authority for supervision of Finland's financial and insurance sectors. The entities supervised by the authority include banks, insurance and pension companies as well as other companies operating in the insurance sector, investment firms, fund management companies, virtual currency providers and the Helsinki Stock Exchange. The FIN-FSA identifies the problems encountered by the markets and supervised entities and takes appropriate action. The supervision supplements controls undertaken by supervised entities and markets themselves. The FIN-FSA ensures that the supervised entities are professionally managed and that they have adequate risk management systems in place and operate according to ethically and professionally qualitative business principles and practices.

Rahoitusvakausvirasto, or, the Financial Stability Authority protects depositors and taxpayers from the effect and expenses of financial crises. It also prevents financial crises and promotes bail-in as part of the Single Resolution Mechanism. It is responsible for the Finnish deposit guarantee system.

**What are the authorization requirements and process?**
Depending on the type of firm, a firm must apply to the Finnish Financial Supervisory Authority (FIN-FSA), Ministry of Finance, Ministry of Social Affairs and Health or the Finnish government for authorization. The FIN-FSA grants authorizations for credit institutions, Finnish life, non-life and reinsurance companies, investment firms, fund management companies and custodians.

The application forms, instructions and list of required appendixes are available at the FIN-FSA web page in Finnish and Swedish. The FIN-FSA shall assess whether the application meets the required threshold conditions within three to twelve months of the submission of the complete application.

Authorization is granted only when the entity seeking authorization meets the necessary regulatory requirements. The key pre-condition is that the entity is managed in a professional manner and in line with sound and prudent business principles. The entity must have sound internal governance and adequate financial resources. The entity's headquarters must be located in Finland.

The FIN-FSA authorizations fee depends on the type of the application ranging from €3,700 to €14,300.

Virtual currency providers must be registered in the register of virtual currency providers maintained by the Financial Supervisory Authority (FIN-FSA). A foreign service provider may conduct its activities in Finland either by establishing a branch or by providing its services across the border. Commencement of activities is contingent on the authorization or notification procedure by the FIN-FSA.

Supervised firms and registered insurance intermediaries as well as service providers that have submitted a notification are listed on the FIN-FSA's list. This information is public and may be accessed from the website of the FIN-FSA.

**What are the main ongoing compliance requirements?**

Fulfilment of the prerequisites of authorization (such as having adequate financial resources and compliance arrangements in place) and acting in accordance with the applicable legislation are ongoing compliance requirements for authorized firms. Authorized entities may also have to comply with specific compliance requirements applicable to certain entities.

Entities supervised by the Finnish Financial Supervisory Authority (FIN-FSA) shall report various information regularly to the FIN-FSA.

Failure to comply with the authorization prerequisites and applicable legislation can result in administrative sanctions for firms and regulated individuals, and loss of authorization.

**What are the penalties for failure to be authorized?**

A person undertaking a regulated activity without being authorized or exempt commits a criminal offence and is liable to a fine or to imprisonment.

**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

A person must not carry on a regulated activity in Finland unless authorized or exempt.

A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in Finland and it does not fall within any of the available exemptions.

The operations of a credit institution, investment firm, fund management company, alternative investment fund manager, custodian or insurance company can only be pursued by entities that have been granted authorization by the Finnish Financial Supervisory Authority (FIN-FSA). Virtual currency providers must be registered in the register of virtual currency providers maintained by the Financial
Supervisory Authority (FIN-FSA).

Authorizations are regulated in the Credit Institutions Act, Investment Firms Act, Alternative investment fund manager Act, Mutual Funds Act, Insurance Companies Act and Act on Virtual Currency Providers. However, some of these acts include provisions which include conditions which also apply when the operations are not regarded as authorized business.

Consumer credit

Consumer credit activities are regulated activities. These activities can only be offered by firms that have been authorized by the FIN-FSA or equivalent authority in another EEA member state or registered as loan providers in accordance with the Act on Registration of Certain Loan Providers and Credit Brokers. The Consumer Protection Act applies to provision of consumer credit. In addition, the Act on Residential Property Consumer Credit Intermediaries regulates providing residential property consumer credit to consumers.

Consumer is defined in the Consumer Protection Act as a natural person who acquires consumer goods and services primarily for a use other than his or her business or trade (elinkeinotoiminnassaan).

Are there any possible exemptions?

Authorizations are regulated in the Credit Institutions Act, Investment Services Act, Alternative Investment Fund Manager Act, Mutual Funds Act, Insurance Companies Act and Act on Virtual Currency Providers. However, some of these acts include provisions which include conditions which also apply when the operations are not regarded as authorized business.

Do any exchange controls or other restrictions on payments apply?

Finland does not operate any foreign currency controls.

Where money is transferred from non-EU member states, imports of foreign currency may need to be declared to customs, but there is no legal restriction on moving money in and out of the country.

There may be anti-money laundering (in accordance with EU Directives No. 2015/849/EU and No. 2015/847) and tax considerations to take into account.

What are the rules around financial promotions?

Rules

According to applicable Finnish Financial Supervisory Authority (FIN-FSA) guidelines, marketing of financial services and instruments means all actions and operations aiming to promote the selling of financial services and instruments. Financial services include all services provided by the various regulated and authorized financial services providers and financial instruments include all instruments provided by the same service providers.

The rules governing marketing and offering of various financial services and instruments are not found in a single piece of legislation but are scattered into service provider and/or financial instrument specific legislation (for more information, see Law and regulation). The objective of the rules is to promote the clarity and high quality of customer and investor information on products and services offered and to ensure appropriate code of conduct of service providers.

The FIN-FSA has issued regulations and guidelines on marketing financial services and instruments as well as regulations and guidelines on codes of conduct when offering financial services and instruments that apply to all service providers and instruments. As a general rule, the rules and guidelines apply both to domestic service providers, such as deposit banks, credit institutions, payment institutions, investment firms, fund management companies, managers of alternative investment funds and insurance companies, and to Finnish branches of EEA-authorized service providers as well as EEA-authorized service providers providing cross-border services in Finland.
In addition to the service provider and instrument specific legislation, the Unfair Business Practices Act includes general requirements on marketing and conducting business in Finland and the Consumer Protection Act regulates financial promotions directed to consumers. These apply also to providers of virtual currencies. The requirements aim to ensure that, among other things, a company's marketing is in accordance with good and acceptable practices, no improper procedures are undertaken and sufficient information is given to consumers prior to entering into a contract.

**Exemptions**

The applicable marketing and offering of financial services and products rules differ depending on the type of the customer. Marketing and offering to consumers and non-professional (private) clients is more strictly regulated than the same towards professional clients and eligible counterparties, which may be exempted from certain requirements.

As regards securities offering, offering securities to the public is more regulated than private placements. According to the Securities Market Act, offering securities to the public means a communication to persons presenting or intended to present sufficient information on the terms of the offer and the security offered, so as to enable to decide to purchase or subscribe to the security.

The Finnish rules are generally applicable also to Finnish branches of EEA-authorized service providers as well as EEA-authorized service providers providing cross-border services in Finland, but there are certain exemptions. For example, the FIN-FSA marketing guidelines do not apply to EEA-authorized service providers providing cross-border investment services in Finland.

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**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

The most common type of legal entity is a limited liability company regulated by the Limited Liability Companies Act. A limited liability company is a body corporate with separate legal personality and which limits the liability of its members. A limited liability company can be either private or public depending on whether or not the shares are offered to the public.

The liability of a company's shareholders is limited by shares (i.e. to the invested share capital), in which case they are liable to pay for their shares but not the company's debts. However, if the shareholders have given separate guarantees for the company's obligations they are also liable for the amount guaranteed if the company does not fulfil the guaranteed obligation.

In addition, many Finnish Banks (usually credit institutions) are established as cooperatives (osuuskunta). Cooperatives are owned by their members and are thus similar to limited liability companies.

In addition, limited partnerships can undertake investment activities. Limited partnerships are formed by a private agreement, which is signed by all of the partners.

**Funds**

Investment funds can take the form of limited partnership when they are classified as alternative investment funds. Mutual funds and special mutual funds are defined as a pool of acquired assets and they are not legal persons. They are managed by fund management companies, who manage the funds in their own name but on behalf and for the benefit of the fund.

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**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes, provided however, that if the company conducts any authorized activities it must be authorized in another EEA country.
A company can conduct lending or investment business in Finland through a branch but this does not create a separate legal entity. The foreign trader must submit a start-up notification concerning its branch to the Finnish Patent and Registration Office before the branch commences its operations. If the business to be conducted and the services to be provided are regulated activities (i.e. it is a branch to a credit institution, insurance company, investment company or management company) then the Finnish Financial Supervisory Authority (FIN-FSA) must also be notified.

If the trader is from a country outside the EEA, it will also need a permit from the Finnish Patent and Registration Office, as well as the FIN-FSA for the establishment of the branch.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending, given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- consumer loans (Fixura and Lainaaja are examples of providers); and
- small and medium-sized enterprises (SME) lending (e.g. Fellow Finance).

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology, in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features, such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over
A wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so called ‘Oracles’. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form, or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture. ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding.

In an ICO the company issues digital tokens or coins that have value inside the company's ecosystem. The tokens or coins can be transferred either to other ecosystems, or for government regulated money.

It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a virtual
currency (as discussed later in detail), a specified investment or form of regulated security, or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally used in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs. In Finland, for example, Taaleri has an authorized robo-advice system.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

**Financial management for businesses**

There are currently several Finnish FinTech companies (Holvi and Zervant are examples) providing online financial management services for SMEs. Such services include, for example, online invoicing, paperless bookkeeping, portfolio management, customer relationship management and reporting.

**Payment technology**

Finnish FinTech companies are also providing different types of online payment services. These include, for example, an application by PayiQ through which a client may acquire tickets for events or public transport.

*Last modified 26 Nov 2019*
Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Finnish Financial Supervisory Authority (FIN-FSA) is the regulator for firms providing financial products and services in both retail and wholesale markets.

GENERAL

A person must not carry on a regulated activity in Finland unless authorized or exempt. A financial activity requires regulatory authorization when it:

- is identified as a specified activity in relation to a specified investment;
- is carried on by way of business in Finland; and
- does not fall within any of the available exemptions.

Where FinTech products and/or applications involve financial activity which require regulatory authorization, the firms providing such products and/or applications must be authorized by the FIN-FSA.

FIN-FSA INNOVATION HELP DESK

To foster the growth and development of startup companies and other innovators, the FIN-FSA has set up an Innovation Help Desk to advise whether an innovation requires authorization and to advise further on permits, registration and other authorization issues. The FIN-FSA Innovation Help Desk is available to both startup companies in the sector and enterprises that are already established and are planning a new type of product, service or way of operating. More information can be found here.

Virtual currency

The Act on virtual currency providers (572/2019) entered into force 1 May 2019. The Act is part of the national implementation of the EU's Fifth Anti-Money Laundering Directive. According to the definition, a virtual currency means a digital representation that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically. Further FIN-FSA regulations and guidelines 4/2019 concerning virtual currency providers enter into force on 1 July 2019.

According to the Act on virtual currency providers, virtual currency issuers, operators of virtual currency exchange services (including marketplaces) and providers of virtual currency custodian wallet services are subject to a registration obligation as of 1 May. Virtual currency providers operating in the market prior to the entry into force of the Act must submit an application for registration with the FIN-FSA by 18 August 2019 in order that their qualification for registration can be assessed by 1 November. New providers considering the launch of activities after the entry into force of the Act may only provide services to customers after their applications for registration have been processed and approved.

Virtual currency providers are considered obliged entities under the Anti-Money Laundering Act as of 1 December 2019, which means that they must report suspicious transactions to the Financial Intelligence Unit of the Police. The FIN-FSA supervises the actions and measures of virtual currency providers related to anti-money laundering and counter-terrorist financing.

Crowdfunding services and peer-to-peer lenders

CROWDFUNDING SERVICES

The Crowdfunding Act (Fi. Joukkorahoituslaki 734/2016, as amended) (Crowdfunding Act) entered into force in September 2016. The objective of the Crowdfunding Act was to clarify the responsibilities of various authorities in the supervision of crowdfunding, to improve investor protection, to diversify the financial markets and to ease the regulation on entities offering crowdfunding services.

The Crowdfunding Act covers both loan-based crowdfunding and investment-based crowdfunding (i.e., which involves the issue of
securities or other instruments), but is not applied to either peer-to-peer (P2P) lending or to money collection. Under the Crowdfunding Act, entities offering crowdfunding services (ie crowdfunding intermediaries) must have a permit issued by, and entered in, a register maintained by the FIN-FSA. Depending on the operating model of the crowdfunding intermediary, the operations may also be subject:

- to other regulations, such as the:
  - Money Collection Act (Fi: Rahankeräyslaki 255/2006, as amended);
  - Sale of Goods Act (Fi: Kauppalaki 355/1987, as amended) and;
  - Consumer Protection Act (Fi: Kuluttajansuojalaki 38/1978, as amended) (as is the case with loan-based crowdfunding); or
- to financial markets legislation, such as the:
  - Credit Institutions Act (Fi: Laki luottolaitostoiminnasta 610/2017, as amended);
  - Investment Services Act (Fi: Sijoituspalvelulaki 747/2012, as amended);
  - Act on Alternative Investment Fund Managers (Fi: Laki vaihtoehtorahastojen hoitajista 162/2014, as amended); and
  - Securities Markets Act (Fi: Arvopaperimarkkinalaki 746/2012, as amended) (with investment-based crowdfunding).

Intermediaries providing services under the Crowdfunding Act are within the optional exemption available to European Union member states under article 3 of the Markets in Financial Instruments Directive (MiFID 1). This means that crowdfunding intermediaries operating under the Crowdfunding Act do not require authorization as MiFID investment firms. Consequently, entities permitted by FIN-FSA to offer crowdfunding services are not within the European Union passporting regime and may not offer crowdfunding services in other European Economic Area (EEA) countries and, vice versa, entities authorized in other EEA countries may not offer such services in Finland without FIN-FSA's permission. It should be noted, however, that this position does not apply to entities which have been authorized to carry out a regulated activity which is within the scope of MiFID I. These include inter alia credit institutions operating under the Credit Institutions Act (Fi: Laki luottolaitostoiminnasta 610/2017, as amended) and investment firms operating under the Investment Services Act (Fi: Sijoituspalvelulaki 747/2012, as amended). Such entities may act as crowdfunding intermediaries under their authorization without needing separate permission for crowdfunding services.

PEER-TO-PEER LENDERS

P2P lending so far, requires no authorization; hence, for example, the administrative staff, internal control or risk management systems of a P2P lending intermediary are not subject to official supervision. This also means that there is no supervision of the credit ratings that may be assigned to borrowers by P2P lending companies. However, authorities have decided that certain participating parties in P2P lending must be entered in a register of credit providers maintained by, and must be supervised by, the Regional State Administrative Agency of Southern Finland (Fi: Etelä-Suomen aluehallintovirasto). Under the Act on Registration of Certain Loan Providers and Credit Brokers (Fi: Laki eräiden luotonantajien ja luotonväittäjien rekisteröinnistä 853/2016, as amended) the lending intermediary must be registered in the register maintained by the Regional State Administrative Agency of Southern Finland if they provide consumer credit or are considered to offer consumer credit, as defined in the Consumer Protection Act (Fi: Kuluttajansuojalaki 38/1978, as amended) or if they act as an intermediary in P2P lending.

Regulation of payment services

Payment services include, for example, account transfers, card payments and direct debits (where the service provider acts as intermediary between payer and payee and transfers funds between the parties in accordance with given instructions). In Finland, payment services can only be provided by service providers that meet the requirements laid down in the Payment Institutions Act (Fi: Maksulaitoslaki 297/2010, as amended), either acting as authorized payment institutions or entities that the FIN-FSA has approved for the provision of payment services without actual authorization.

Payment services can be provided without authorization, as long as the total value of completed transactions does not exceed:

- for natural persons, an average of €50,000 a month over a period of 12 months; and
- for legal persons, an average of €3 million a month.

However, those providing payment services without authorization must submit a notification to FIN-FSA prior to the commencement of the service. After receiving such a notification, FIN-FSA investigates whether the service provider meets the statutory requirements.
• A natural person cannot be authorized as a payment institution.

• Legal persons must apply for authorization as a payment institution if the total value of their payment services exceeds the above-mentioned limit.

• A credit institution may provide payment services based on its own authorization.

• A foreign payment institution authorized in EEA may also provide payment services in Finland, provided that proper notification is made to FIN-FSA.

The legal requirements for the provision of payment services, such as the disclosure requirements and contract terms and conditions, are laid down in the Payment Services Act (Fi: Maksupalvelulaki 290/2010), as amended. It regulates, for example, the service provider's obligation to provide information to end users on the terms of the relevant agreement governing the provision of the services and executed payments. It also regulates how payments are executed, what the terms and conditions are, and what responsibilities the parties have.

FIN-FSA supervises terms and conditions, disclosure obligations and the carrying out of such services in respect of payment institutions, credit institutions and their agents.

The European Union's Payment Services Directive II has been transposed into Finnish law through changes to the Payment Institutions Act and the Payment Services Act. It can be noted that the FIN-FSA complies with European Banking Authority's proposed additional time for strong customer authentication in e-commerce card-based payments and such requirements must be implemented by 31 December 2020.

Application of data protection and consumer laws

General principles of processing and disclosing personal data are regulated by the European General Data Protection Regulation (GDPR), supplemented by the Personal Data Act of Finland (Tietosuojalaki 1050/2018, as amended). Criminal liability may ensue if obligations of the Data Protection Act are not followed.

In addition to sector-specific regulations, general consumer protection regulation applies to the provision of payment services to consumers. A consumer is defined in the Consumer Protection Act (Fi: Kuluttajansuojalaki 38/1978, as amended) as a natural person who acquires consumer goods and services primarily for other purposes than to his or her professional purposes. The Finnish consumer ombudsman supervises the terms and conditions and disclosure obligations and the carrying out of such services in respect of payment services providers without authorization, where the users of the service are consumers.

Money laundering regulations

Payment services providers must comply with anti-money laundering requirements as provided in the new Finnish Act on Preventing Money Laundering and Terrorist Financing (Fi: Laki rahanpesun ja terrorismin rahoittamisen estämisestä 444/2017, as amended), which entered into force in July 2017. The new Act implements the European Union's Fourth Money Laundering Directive.

Last modified 26 Nov 2019

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by, for example, the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

THE FINNISH FUNDING AGENCY FOR TECHNOLOGY AND INNOVATION (TEKES)
Tekes is the most important public funding agency for research funding in Finland. Tekes provides funding to transform research-stage ideas into viable businesses, and may combine direct unconditional funding with Tekes-guaranteed loans, conditional on the success of the resulting business.

**ANGEL INVESTORS**

Business angel financing has developed as an important source of early stage capital for startups. A business angel is an individual who provides capital for a startup and usually in exchange for convertible debt or ownership equity. Business angel funding is also provided through cooperative platforms, such as the Finnish Business Angels Network (FiBAN).

**ACCELERATORS**

Accelerators, which are normally set up by business communities, governments or academic centers provide essential mentoring, capital and connections for FinTech companies. Accelerators had an important role in startup financing some years ago but their relevance has, however, since declined.

**CROWDFUNDING**

Crowdfunding is available but is not a common way of funding for a FinTech business, because the business ecosystems around FinTech are typically highly complex and not easily marketable to the public. Crowdfunding involves members of the public investing in a business by pooling their resources through an intermediary platform. The idea of crowdfunding is, that a large number of investors make relatively small investments through an online platform to a certain company, which usually is in its early stages.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

**Peer-to-peer platform funding**

One form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead interest is paid on the money borrowed.

**Senior bank debt and capital markets funding**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis, depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

In Finland both debt and equity capital markets are accessible to businesses (usually of a certain size).

A FinTech company may raise finance by listing on First North, which is a Nordic alternative market designed for small and growing companies. The First North market is maintained by local NASDAQ OMX stock exchange companies (in Finland NASDAQ OMX Helsinki Oy). Using a less extensive rulebook than the main market, the First North market provides companies with more room to focus on their business and development, while still taking advantage of all the positive aspects of being a listed company. The First North market runs in the Nordic stock exchange parallel to the main market, where the shares are traded in a single trading system. For investors, First North
offers an opportunity to invest in companies that are in an interesting stage of their growth. Many large and established companies began their journey on First North, creating growth and gaining experience. Many of these companies went on to listing on the NASDAQ regulated main market.

As an alternative to bank or other types of financing, Nordic companies are increasingly funding themselves via corporate bonds. The benefits of corporate bonds include, for example:

- the possibility for longer maturities;
- fixed interest rates and bullet repayment (ie no amortization);
- reduced dependency of banks;
- less detailed terms compared to bank loans; and
- transparency in secondary market pricing.

The Nasdaq First North Bond Market is an alternative marketplace with an efficient admissions process. On the Nasdaq First North Bond Market, bonds can be admitted to trading without having a prospectus approved by the Finnish Financial Supervisory Authority or without a need to comply with IFRS accounting standards. Due to these reasons, issuing bonds on the Nasdaq First North Bond Market can be seen as a tempting alternative for FinTech companies as it allows them to concentrate on developing their core business.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Transfer** – A transfer is a full legal transfer of the loan agreement, including all rights and obligations of the lender as well as the underlying security. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

- **Assignment** – An assignment is a transfer of lender's rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. An assignment can be effected as either an equitable assignment or legal assignment depending on whether certain statutory requirements have been satisfied.

- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

- **Securitization** – In a securitization transaction the creditor/issuer creates a financial instrument by combining and repacking loans and selling the related cash flow to investors in a form of securities.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

What are the main considerations when transferring a loan and related security?

There are a number of issues to be considered before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:
• **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;

• **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;

• **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;

• **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

• **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms;

• **consent** – whether a transfer requires the consent or notification of any other parties;

• **lender’s position** – according to Finnish law, the transferee of a loan will not obtain a better position towards the borrower than the original transferor (thus, to the extent the borrower may present claims against the original lender, it may also present such claims against the new lender);

• **security** – whether the loan is covered by guarantee or other security (Finnish law does not recognize an assignment of security. However, under Finnish law, secured loans can be transferred and the general rule is that, as an ancillary obligation, the guarantee/security associated with the loan is transferred together with the debt which is typically expressly permitted under the financing documents.); and

• **syndicated loans** – usually, a security agent is appointed to act for and on behalf of all lenders (no further actions, other than notices in the loan documents, are usually required to transfer the benefit of the security if the composition of the bank syndicate changes).

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**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Finland varies according to the asset class. The main asset class may be divided into:

• **economic infrastructure** (energy, aviation, rail, telecommunications, water, roads and waste); and

• **social infrastructure** (education, health and justice/prisons, housing).

Key sectors are considered below.

**Energy**

Finland’s electricity market was gradually opened to competition after the passing of the Electricity Market Act in 1995. Since late 1998, all electricity users, including private households, have been able to choose their preferred electricity supplier. Monopolistic electricity transmission is regulated and supervised by the national authority, which in Finland is the Finnish Energy Authority.

**Fingrid Oyj** is responsible for the electricity transmission in the high-voltage transmission in Finland. Republic of Finland owns approximately 28% of the shares, National Emerge Supply Agency 25% and Ilmarinen Mutual Pension Insurance Company 20%. There are approximately 76 electricity distribution network operators in Finland. Sale of electricity does not require permit but is regulated and supervise by the authorities. The electricity market also allows electricity consumers (including households) to practice small-scale electricity production and sell the energy on the market.

The electricity market is regulated by the Electricity Market Act and Government Decrees based on the Electricity Market Act. The Energy Authority monitors compliance with the electricity market legislation and promotes the operation of the competitive electricity and natural gas markets.
From the beginning of 2020, the Finnish natural gas transmission network will be operated by state-owned gas transmission operator, Gasgrid Finland. Under the Natural Gas Market Act the wholesale and retail natural gas markets will be opened for competition at the beginning of 2020. Simultaneously the previous TSO, Gasum will be unbundled and Finland is not anymore an isolated market.

**Telecoms infrastructure**

The telecommunication networks in Finland are privately owned by a number of service providers. Elisa, TeliaSonera and DNA, which is a subsidiary of the Norwegian Telenor.

The Finnish Transport and Communications Agency Traficom steers and supervises compliance with the provisions and regulations that apply to its field of activity. Traficom's steering and supervision applies to telecommunications operators, TV and radio operators, users of radio frequencies, postal operators, and several players related to electronic communications networks.

**Transport infrastructure**

**LIGHT RAIL**

Light rail systems (metro and trams) in Helsinki are managed by the Helsinki City Transport (HKL) that is owned by the City of Helsinki. HKL owns the tramways, metro tracks and metro stations of Helsinki, as well as the trams and metro trains themselves. Further, HKL owns the public transport infrastructure in Helsinki and is in charge of developing and maintaining it. Other cities in Finland do not have light rail public transportation.

**HEAVY RAIL**

In Finland the rail passenger market is not yet open to competition and VR is the only train operating company in Finland. The rail freight market was fully opened to competition in 2007, with the first new entrant on the market in 2012.

The Finnish Transport Agency is responsible for the state-owned railways. The transport system is maintained and developed in cooperation with other actors, such as VR Tracks, a subsidiary of the VR Group.

**ROADS, BRIDGES AND TUNNELS**

Together with the regional ELY Centers, the Finnish Transport Agency is responsible for the maintenance and development of the state-owned road network. The Finnish road network comprises highways (owned by the State), municipal street networks (maintained by municipalities) and private roads (owned by private individuals or associations, and are mainly used to enable the passage to private lands and may only be used by those who own the roads). Private roads may only be established by application and in accordance with the Act on Private Roads. The public sector does not currently outsource the construction, maintenance or operation of roads. It does however, use public procurement procedures when planning and contracting and maintaining roads. For example, Public-Private Partnership (PPP) financing models have been used in motorway projects (eg E18 Muurla-Lohja motorway).

**AVIATION**

The basic rules governing aviation in Finland can be found in the Aviation Act and in EU regulations directly applicable in all member states. Some of the market is privatized however, the principal actors on the market are government owned companies. For example the biggest airline is Finnair, of which the state owns almost 60%. However, airports themselves and the aviation infrastructure are not privatized and are all owned by the state of Finland. The maintenance of all airports is the responsibility of Finnavia Oyj, which is a public limited liability company owned by the state.

**PORTS**

In the past, the ports in Finland have been public utilities of municipalities but after the decision of the European Commission, the ports were incorporated and are nowadays limited liability companies. The ports are however, mainly in the ownership of municipalities or a group of municipalities. Also, the industrial sector owns some ports for the purposes of their industry.

**Other infrastructure**
SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES, CENTERS/PRISONS)

Typically, all are owned by the public sector.

_Hospitals/healthcare_

Healthcare in Finland consists of a highly decentralized, publicly funded healthcare system and a relatively small private sector (mainly consisting of occupational health care, provided to employees by their employer as a work benefit and also of few private hospitals and healthcare hubs). Each person residing in Finland has the right to healthcare services.

The Ministry of Social Affairs and Health is the highest decision-making authority regarding healthcare, but the municipalities are responsible for providing healthcare to their residents. The municipal financing of healthcare consists of two sources; municipal taxes and user fees. The municipalities also have the right to receive state subsidies, if their tax levy is not adequate for providing the public services required.

The private sector is relatively small and the barrier to using private healthcare services are high due to the higher service fees. However, the Social Insurance Institution (KELA) reimburses a significant share of the cost.

There is an ongoing social welfare and healthcare reform in Finland, the objective of which is to create financially viable bodies as service organizers (including private sector bodies), and to also to achieve complete horizontal and vertical integration of social welfare and health care services. This reform is expected to offer opportunities to investors.

_Schools_

Schools are generally owned by the public sector (mainly municipalities). However, schools may outsource certain services such as building, maintenance and other projects to private sector entities.

_DEFENSE_

Defense assets are owned by the public sector.

_WASTE_

The municipalities must organize the recovery and treatment of hazardous agricultural waste and domestic waste. In addition to this, municipalities are responsible for the urban waste produced by public administration services and the education sector. Municipalities also distribute information and offer guidance on waste management. Municipal responsibilities are described in more detail in Section 32 of the Waste Act. In practice, many municipalities sub-contract most of their waste management duties to local companies.

_WATER_

The municipalities are responsible for the arranging of water and wastewater services in Finland but water supply establishments usually provide the services. The regional ELY Centers as well as the municipal health authorities regulate and supervise the water sector.

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**Are there special rules for investing in energy and infrastructure?**

_Generally_

There is no specific regime governing or restricting investment in energy or infrastructure projects in Finland over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made) the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission; and a project may need environmental authorizations and/or sector specific regulatory consents or licenses.

_Energy_

The energy markets in Finland are open to competition (with the exception of Åland) and there are no restrictions on entering into the
market. However, the regulation is fairly complex: while the production and sales of electricity are open to competition, distribution activities are divided into regional monopolies, subject to permits and are under the surveillance of Energy Market Authorities.

Production activities are heavily regulated and supported by legislation and authorities (eg for environmental reasons).

Electricity production facilities are capital-intensive and investments in them are long-term investments. The functioning of the markets, legislation and predictability of such markets and legislation are influential considerations to investments in electricity production facilities on a commercial basis.

The most important legislative development in Finland pertaining to renewable energy took place in June 2018 by the amendment of the Finnish Act on Production Subsidy for Electricity Produced from Renewable Energy Sources (1396/2010, Fi: laki uusiutuvilla energialähteillä tuotetun sähön tuotantotuesta), which implemented a new support scheme for renewable energy based on technology-neutral premium based tender process.

The Act adopts a new tendering system for renewable energy subsidies. Unlike in the previous feed-in tariff system, under the new auction-based tendering system the state will define the annual target amount of renewable energy for each tendering round, and eligible electricity producers will then file their bids with the Finnish Energy Authority.

During each tendering round, the producers must determine the premiums (i.e. the amount of support from the state) they require for producing energy and the predicted annual volume of their energy production. The projects will then be ranked based on the bids, and those with the lowest premium rates will be accepted in ascending order until the annual target amount of renewable energy production is reached. The premium offered would have to fall under the threshold price of the process, which to start with is EUR 53.5 per MWh, i.e. the same as under the current feed-in tariff system. The state will grant premiums for the accepted projects for a maximum period of 12 years.

The first (and so far the only) auction round took place between 15 November and 31 December 2018. The annual electricity production available for auction was 1.4 TWh.

The principal legal framework regarding energy markets consists of the Act on Electricity Markets and the Act on Natural Gas Markets.

Corporate PPAs:

Corporate power purchase agreements (PPAs) for renewable energy have only recently entered the Finnish renewable energy market. This results from the fact that while the installed capacity of wind energy has doubled within two years to roughly 2,000 MW in Finland in 2018, a majority of these wind energy investments were made with the support of state aid from the previous feed-in tariff scheme, which was closed at the end of 2017.

Registration and reporting obligations under REMIT:

Undertakings active in the electricity sector are preparing for registration and reporting obligations under REMIT to enter into force gradually in force in Finland. Registration and reporting obligations, as well as ensuring compliance with several partially overlapping regulatory regimes (REMIT, financial regulation, competition law), increase the administrative burden and costs of numerous undertakings active in the sector.

Currently, it is hard to anticipate the exact effects of the REMIT regime in Finland and on the Nordic electricity markets, and much will also depend on the actual activity of the Energy Authority, Financial Supervisory Authority and their cooperation with other relevant domestic and supranational authorities.

Telecoms infrastructure

The telecoms markets are heavily regulated and certain activities are subject to permits (eg network permits) from the FICORA. However, FICORA actively intervenes in competition problems detected on the broadband and telephone markets, which enables new and innovative service providers to enter the markets.

The principal legal framework consists of the Information Society Code, which regulates most parts of the field.

Transport infrastructure
There is an ongoing legislation project to implement a new Traffic Code, which will also affect the legal framework regarding transportation more generally.

In Finland, the rail passenger market is not yet open to competition and VR is the only train operating company in Finland. The tracks however, are the responsibility of the Finnish Transport Agency who procures the planning, building and maintenance from companies in the field. VR Tracks is the principal actor in the market. The rail freight market is open to competition.

Maintenance of the roads is on the responsibility of the government. The public sector usually procures services for road projects from private sector entities, who carry out the projects. However, these actions are not outsourced.

What is the applicable procurement process?

Finnish public procurement is subject to national procurement legislation (Act on Public Contracts and Concessions). In addition, there are sector-specific regulations, such as the act regarding public contracts and concessions on certain special fields (ie water and energy maintenance, traffic and postal services) and the Act on Defense and Security Public Contracts. These implement the EU directives on public procurement.

Under these regulations, public sector procurement must follow transparent open procedures ensuring fair and non-discriminatory conditions of competition for suppliers.

Investing in energy and infrastructure

Public procurement is relevant where a public unit is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal, which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to certain public bodies including central government departments, local authorities etc.

A regulated procurement is required where certain financial thresholds are met. On most major infrastructure projects, it is likely that those thresholds will be met so a regulated procurement would need to be run.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures (please note that in the procurements subject to the act regarding public contracts on certain special fields, ie water and energy maintenance traffic and postal services, the procedure is more flexible than described below in accordance with the Act on Public Contracts):

- **Open procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than limited clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer’s bid.

- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

The Competition and Consumer Authority supervises the compliance of the procurement regulations and it may issue reminders to procurement units if it observes unlawful conduct, and, in the case of illegal direct procurement, it may prohibit the implementation of a procurement decision. The authority may also propose that the Market Court impose sanctions. The Market Court is the court which hears public procurement cases (appeals) in the first instance.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding are:

**Funding**

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis;
- bond finance;
- mezzanine debt (in some sectors, generally not very common in Finland); and
- refinancing of the debt in operational projects.

Funding/funding products can also, sometimes, be provided by the European Investment Bank and export credit agencies.

**Investing**

Common forms of investing in energy and infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of 'equity').

Restructuring

**Enforcement and sanctions**

*When can there be regulatory investigations?*

The supervisory powers of the Finnish Financial Supervisory Authority are defined in the Act on the Financial Supervisory Authority. These powers include the right to perform inspections of supervised entities, or, when deemed necessary, other financial market participants and to obtain documents and other records necessary for the conduct of supervision. The powers also include the right to convene meetings of authorized supervised entities with decision-making and administrative powers and to attend these meetings.

*What regulatory penalties may apply?*

The Finnish Financial Supervisory Authority (FIN-FSA) may exercise supervisory powers in respect of financial markets, such as temporary prohibition from holding a managerial position in a supervised entity and curtailment of operations subject to authorization.

In addition, the FIN-FSA may impose administrative sanctions, ie administrative fines, public warnings, and penalty payments. FIN-FSA may also request a police investigation.

*What criminal penalties may apply?*

Criminalized activities include *inter alia*:
• insider dealing, misleading statements and practices and manipulating the markets;
• breaches of money laundering regulations; and
• conducting regulated activities without authorization.

The criminal penalties vary between fines and imprisonment.

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There are no stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There are no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

There are no stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over the Finnish tax authorities on the enforcement of security.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

No, but withholding tax can be levied in a few exceptional cases. These are very rare in practice. These exceptional cases include where interest is paid to a person who is not resident in Finland on:

• additional investments into Finnish funds;
• deposits into staff cash pools;
• deposits into co-operative cash pools;
• debt between private individuals where the creditor ceased to be resident for tax purposes in Finland after the debt arrangement was put in place; and
• debt which is recognized as a capital investment for tax purposes.

If so:

What is the rate of withholding?

In the exceptional cases where withholding tax applies, the rate of withholding tax is 20%, where the interest is paid to a company not resident in Finland, and 30% where the interest is paid to an individual not resident in Finland.

What are the key exemptions?

An exemption from the application of withholding tax in the exceptional cases in which it applies may be available, in whole or in part, under the terms of a double tax treaty entered into by Finland, provided that the requisite conditions are met.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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Key contacts

Hans Sundblad
Partner
DLA Piper Finland Attorneys Ltd
hans.sundblad@dlapiper.com
T: +358 9 4176 0421
France

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both French and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in France or to request that they are admitted to trading on a regulated market operating in France unless an approved prospectus has been submitted for approval to the French regulator (Autorité des Marchés Financiers) and made available to the public.

The Autorité des Marchés Financiers has provided guidelines and instructions for the issuance of debts securities and the distribution of marketing materials to the public.

What are common issuing methods and types of debt securities?

The most common methods of issuing debt securities in France are on a standalone basis or under a program. The program method is for an ongoing series of issues governed by a set of legal documentation while standalone issuance is for one particular issuance of debt securities.

Many different types of debt securities are offered in France. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities;
- guaranteed securities, subordinated securities, perpetual debt securities (ie debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset – including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (ie securities with both debt and equity features);
- equity-linked securities such as convertible bonds (ie debt securities convertible into the equity of the issuer);
- exchangeable bonds (ie debt securities convertible into the equity of a third party);
- depositary receipts (ie security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
• warrants (ie securities giving the holders the option to purchase the equity of the issuer or a related company).

What are the differences between offering debt securities to institutional/professional or other investors?

The Prospectus Directive does not make a distinction between professional and other investors for the purposes of its disclosure requirements but does include different disclosure regimes by reference to the minimum denomination of a single security.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the 'wholesale' rules apply. If the denomination is under €100,000, the 'retail' rules apply. Additional disclosure requirements apply for retail securities.

When is it necessary to prepare a prospectus?

Under the Prospectus Directive, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

The obligation to publish a prospectus does not apply to offers made to the public if it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per European Economic Area state or where the minimum denomination per unit is at least EUR100,000.

The definition of 'qualified investor', following the implementation under French law of Directive 2010/73/EU has been aligned with the definition provided under the Markets in Financial Instruments Directive. Pursuant to article D. 411-1 of the French Monetary and Financial Code, in order to be a qualified investor, a person needs to be either a professional client or an eligible counterparty.

If the offer is deemed not to be made to the public, a prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market.

What are the main exchanges available?

Market operator NYSE Euronext manages the Euronext Paris regulated markets in France.

Is there a private placement market?

France has an active private placement market. The documentation is generally standardized (such as the Euro PP standard).

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to provide comprehensive information in relation to their financial situation and activities as well as to provide risk factors to bring the attention of investors. Issuers are accountable and liable for misleading or inaccurate information provided in their prospectus or information memorandum.

Investing in debt securities
Specific risks factors related to the securities and the ability of the issuer to repay the securities are generally provided for under the prospectus or the information memorandum. Typically, an investor may lose all his investment in case of insolvency or inability of the issuer to fulfil his payment obligations.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Depending on the characteristics of the fund (offered to professional or nonprofessional investors), alternative investment funds (AIFs) must be authorized by or notified to the Financial Markets Authority (Autorité des Marchés Financiers) (AMF).

What are common fund structures?

Several fund structures are listed by the Monetary and Financial Code (Code monétaire et financier):

- retail investment funds;
- funds of alternative funds;
- private equity funds;
- employee investment undertakings;
- real estate collective investment undertakings (OPCI);
- real estate investment companies (SCPI);
- forestry investment companies (SEF);
- closed-ended investment companies (SICAF);
- professional investment funds (FPS which take the form of (i) mutual fund (fonds commun de placement) or (ii) société en commandite simple (SLP));
- professional private equity funds;
- professional real estate collective investment undertakings; and
- financing entities, which includes securitisation entities and specialised financing entities (organismes de financement spécialisés).

These funds generally take the form of investment companies with variable capital or mutual fund (fonds commun de placement) with no legal personality.

Others fund structures (Autres FIA) are not listed by the Monetary and Financial Code (Code monétaire et financier) and fall within the scope of AIF by meeting the criteria of the definition referred to in Article 3 of the AIFM Directive.

What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Retail funds, including Undertakings for Collective Investment in Transferrable Securities (UCITS), are subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depository arrangements for assets, investment and borrowing powers specifications, concentration requirements and other matters.
Institutional/professional funds

Professional funds can only be marketed to professional clients as defined in the MiFID.

Professional funds that are offered in France are subject to the Alternative Investment Fund Managers Directive regime in relation to authorization of the manager/fund, marketing arrangements, reporting, depositary arrangements for assets and governance etc.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Managing investments is a regulated activity under French law and therefore subject to authorization. Certain investment vehicles which do not fall within any of the categories of alternative investment fund (AIF) under the Monetary and Financial Code (Code monétaire et financier) may nevertheless be subject to regulatory obligations if they fall within the definition of AIF as defined in the Alternative Investment Fund Managers Directive.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

French selling restrictions

Generally in France, offering securities or interests in alternative investment funds (AIFs) is covered under the Monetary and Financial Code (Code monétaire et financier) and the General Regulation of the AMF, which implement in French law the Undertakings for Collective Investment in Transferable Securities Directive and the Alternative Investment Fund Managers Directive.

Undertakings for Collective Investments in Transferable Securities (UCITS)

UCITS, including those established in France, have an EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Alternative Investment Funds (AIFs)

An alternative investment fund manager (AIFM) may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).

Reverse solicitation and the definition of ‘marketing’

The act of marketing AIFs consists in presenting the products on French territory by different means (advertising, direct marketing, advice, etc) with a view to encouraging an investor to subscribe to or purchase such AIFs. If units or shares of AIFs are marketed as defined above, those units or shares are considered as being marketed in France and the manager of the AIF must comply with the legal and regulatory framework applicable to the marketing of AIFs (eg Financial Markets Authority (Autorité des Marchés Financiers) (AMF) authorization or EU passport).

The AMF expressly considered in its AIF marketing guidelines that the purchase, sale or subscription of units or shares of an AIF in...
response to a client's unsolicited request to purchase a specifically designated AIF, provided that the client is authorized to do so, would not be considered as an act of marketing in France (Reverse Solicitation). Any entity wishing to rely on the Reverse Solicitation exception should document all of its communications with potential investors.

*Last modified 4 Dec 2019*

**Are there any restrictions on managing a fund?**

Managing a fund is a regulated activity. Any entity managing funds must be authorized by the AMF before commencing its activities.

*Last modified 4 Dec 2019*

**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

The [European Market Infrastructure Regulation](#) applies to all derivative transactions and requires transactions to be reported to trade repositories, for relevant transactions (certain classes of over-the-counter (OTC) derivatives above certain thresholds) between dealers to be cleared, or when derivatives are not centrally cleared, subject to risk mitigation techniques such as initial margin and variation margin requirements.

Local authorities may only enter into derivatives contracts for hedging purposes and subject to the fulfilment of other specific conditions.

In addition, the French regulators have provided instructions to be complied with in respect of the marketing and the transparency obligation applicable to banks and investment services providers offering complex derivatives products. Unless an exemption applies, investment services on financial contracts (i.e. derivatives contracts) require a license in France (or a passport) to provide the relevant investment service.

*Last modified 4 Dec 2019*

**What are common types of derivatives?**

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contracts are widely used in France:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying assets seen in France are:

- equity;
- fixed income instruments;
- commodities;
- emission allowances;
- indexes;
- foreign currency; and
- credit events.
Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007 to 2008, many regulations have been enacted with the intention of monitoring and/or regulating derivatives markets. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing, limiting the scope of title transfer, by generally prohibiting such type of collateral in case the counterparty to the financial counterparty is a non professional client (e.g. retail);
- improve the management of operational risk by increasing the standardization of derivatives contracts;
- provide rules for the collection and posting of initial and variation margins;
- improve banking secrecy (e.g. for redit derivatives); and
- provide rules on miscelling/good conduct.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

If the lending activity is performed on a regular basis, the lender must be authorized.

Borrowing

Borrowing is generally not regulated. However, depending on the circumstances, borrowers should insure that lenders are duly licensed.

What are common lending structures?

There is no mandatory lending structure in France; lending can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities or project facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
• a standby or bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Loan security**

A loan can either be secured, unsecured or guaranteed.

**Loan commitment**

A loan can also be:

• committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

**Loan repayment**

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or in full on the maturity date.

**What are the differences between lending to institutional/professional or other borrowers?**

The main differences concern lending to consumers. This type of lending is governed by the Consumer Code (Code de la consommation) and lenders are subject to additional obligations regarding in particular:

• advertisement of consumer credit transactions;
• pre-contractual and contractual information obligations are reinforced; and
• evaluation of the consumer's solvency.

**Do the laws recognize the principles of agency and trusts?**

**Agent**

**COMMON AGENCY RULES (MANDAT)**

Security interests have traditionally been granted under French law in favor of a security agent, acting in the name and on behalf of the beneficiaries. Such regime raises, however, several difficulties in practice (eg in case of court proceedings).

**SPECIFIC PROVISIONS OF THE FRENCH CIVIL CODE (CODE CIVIL)**

As a result of the imperfection of the common agency rules (mandat), the French lawmaker created a specific set of rules for the security agent (providing that any security may be constituted, registered, maintained and enforced on behalf of its beneficiaries by an agent appointed in the agreement under which the secured obligations arise) (Art. 2488-6 and seq. of the French Civil Code). Albeit the legal regime of the security agent has been clarified pursuant to the ordonnance n°2017-748 dated 4 May 2017, it is still not widely used in practice since the market and the legal practitioners need to get used to it.

**Trust in a context of security taking/similar mechanism**

**PARALLEL DEBT MECHANISM**

Security interests can be granted under French law in favor of a security agent to the extent only such security agent has been appointed pursuant to 2488-6 and seq. of the French Civil Code (cf. above paragraph).
Otherwise, in practice, and to the extent valid under the law governing the loan agreement, the loan agreement may provide for a ‘parallel debt’ obligation due by the borrower to the security trustee, which can be secured by a French security granted in favor of the security trustee. This ‘parallel debt’ mechanism may, however, not be used in respect of security that is exclusively granted in favor of a lender (e.g. a Daily assignment, pledge over tools and equipment or pledge over inventory).

**FRENCH LAW TRUSTS (FIDUCIE-SÛRETY)**

Under French law, it is possible to transfer the ownership of assets to a trustee (*fiduciaire*) in order to guarantee obligations owed to third parties. The trustee (*fiduciaire*) shall (i) hold such assets segregated from its own assets and (ii) following the occurrence of an enforcement event, transfer the ownership of such assets in accordance with the beneficiaries’ instructions. It is, however, uncommon to use such a security structure in France.

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**Are there any other notable risks or issues around lending?**

**Generally**

Lenders are required to inform any borrower (professional or consumer) of the percentage rate of charge (taux effectif global) of the loan.

Since the ordonnance n°2019-740 dated 17 July 2019, if a lender fails to provide the percentage rate of charge (taux effectif global), such lender may not be entitled to receive the contractual interest rate of the loan, up to a proportion to be determined by a judge, depending on the damage actually suffered by the borrower.

**Specific types of lending**

Consumer and mortgage credit rules aim to prevent irresponsible lending to consumers and impose a number of requirements on lenders including the need to, among other things:

- conduct affordability tests before lending; and
- provide standard information about the credit to enable borrowers to compare products (e.g., annual percentage rate of charge).

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**Are there any other notable risks or issues around borrowing?**

Borrowers should be aware of the potential implications of the EU’s Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to ‘bail in’ obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. ‘Bail in’ describes a variety of write-down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of French or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

In certain circumstances, the agent must be licenced as creditor or payment institution (or duly passported in France for such activities) or as loan broker (“intermédiaire en opérations de banque”) and registered as such with the French dedicated authority (ORIAS).

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**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**
Capacity

It is important to check the constitutional documents of a company giving a guarantee or security and relevant provisions of French law applicable to it in order to check:

- whether such a transaction is within its corporate objects (objet social);
- who are the persons entitled to bind the company towards third parties (ie the legal representatives of the company);
- whether any corporate approval is required prior to the execution of the relevant security document by its legal representatives (In international transactions, even if not expressly requested by the articles of association of the company, it is market practice to request that resolutions be taken by a corporate body of the company so as to confirm that the transaction is useful to the implementation of its corporate object (utile à la réalisation de son objet social) and in its corporate interest. Compliance with corporate interest is a matter of fact and requires a careful review, in particular regarding any upstream or cross-stream guarantee or security provided by a subsidiary to its parent or sister company.); and
- the security document constitutes a regulated convention (conventions réglementées), as defined under French law and, as the case may be, the articles of association of the company. (Depending on the legal form of the company, French law provides for specific procedures to be complied with in the case of agreements entered into between, for example, the company and any of its shareholders holding more than 10% of its share capital. Specific advice should be sought on a case-by-case basis.)

Execution by same authorized representative

Pursuant to article 1161 of the French Civil Code (Code civil), where the same physical person acts as authorized representative of one or several other physical persons party to the same agreement, this may lead to the nullity of the said agreement, unless expressly approved or ratified by the represented physical persons. The scope of this provision has been clarified pursuant to a law n°2018-287 dated 20 April 2018 and no longer encompass the representations of companies.

Insolvency

HARDENING PERIOD (PÉRIODE SUSPECTE)

Under French law, security interests granted to secure previously existing debts are null and void if they are granted during the hardening period (période suspecte) (ie the period from the date the pledgor became insolvent up to the date of the opening judgement, the duration of such period being up to 18 months prior to the date of the opening judgement).

DISPROPORTIONATE SECURITY INTERESTS

In the event of insolvency proceedings being opened against a company, if guarantees and security interests granted in favor of a creditor are disproportionate to the loan granted or credit extended to the company, the security interests of such creditor may be challenged and such guarantees and security interests may be nulled or reduced by a French judge.

Financial assistance

It is unlawful for any société anonyme and société par actions simplifiée to advance funds, grant loans or provide a security or a guarantee for the purpose of enabling a third party to acquire or subscribe its shares. However, the financial assistance rules do not apply to:

- operations carried out by credit institutions and finance companies in the normal course of their business;
- operations carried out for the purpose of the acquisition or subscription by employees of shares of the company, of one of its subsidiaries or of a company coming within the scope of a group savings plan (plan d’épargne de groupe) as provided by article L.3344-1 of the French Employment Code (Code du Travail); and
- any security or guarantee provided for any part of the debt which is not used to acquire or refinance the acquisition or subscription of shares.

What are common types of guarantees and security?
Common forms of guarantees

Guarantees can take a number of forms, the more common ones being:

- a corporate guarantee (cautionnement), which is an undertaking taken by a guarantor towards a beneficiary to pay a debtor’s debt in case of non-payment by the latter (such guarantee is ancillary to the principal obligation – the obligations of the guarantor are closely linked to the obligations of the main debtor);

- an autonomous guarantee (garantie autonome), which is an undertaking taken by a guarantor, in light of a third party’s obligation, to pay a sum of money to a beneficiary on first demand or upon the terms and conditions agreed between the parties (it is a non-ancillary separate and distinct obligation – the guarantor may not raise any exception pertaining to the obligation of the debtor and, unless otherwise agreed between the parties, such guarantee does not follow the guaranteed obligation); and

- a letter of intent (lettre d’intention, lettre de confort or lettre de patronage), which is an undertaking to do or not to do, so as to support a debtor in the performance of its obligation towards the creditor (its purpose is to ensure that the debtor will be in a position to satisfy its obligations – otherwise, the issuer of the letter will have to indemnify the creditor for any damages incurred because of such failure).

Common forms of security

There are three basic types of security interest that can be created under French law and that are suitable for securing different types of assets:

- a pledge over non-tangible property (nantissement) (such as financial securities accounts (nantissement de comptes de titres financiers), receivables, bank account and intellectual property rights);

- a pledge over tangible property (gage) (such as stock or equipment); and

- a mortgage (hypothèque) over real estate, vessels or aircrafts.

Under French law, as a matter of principle, there is no assignment for security purposes, except:

- the so-called ‘Daily assignment’ of receivables; and

- the French trust for security purposes ‘fiducie-sûreté’ (which is only used in practice under exceptional circumstances).

It is not possible to grant security over all of the assets of a company, such as an English law debenture. The closest security would be to grant a pledge over business (nantissement de fonds de commerce), which covers the logo, commercial name, commercial leasehold, customers, some fixed assets (equipment, machinery and tools) and intellectual property rights.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

The main points that should be checked are as follows.

SPECIFIC RULES APPLICABLE TO GUARANTEES GRANTED BY COMPANIES

The French Commercial Code provides for rules applicable to certain guarantees granted by companies. For instance, it is not possible for some companies to guarantee the obligations of managers and shareholders and/or directors. Specific advice should be sought depending on the form of company.

HANDWRITTEN WORDING TO BE INSERTED IN A CORPORATE GUARANTEE (CAUTIONNEMENT)

In a guarantee granted by a private deed, it is required that the guarantor write by hand the amount of the secured obligations in words.
and figures.

SPECIFIC RULES APPLICABLE TO CORPORATE GUARANTEE (CAUTIONNEMENT) GRANTED BY INDIVIDUALS

The French [Consumer Code (Code de la consommation)] provides for specific rules applicable to corporate guarantees granted by individuals. In particular, the guarantors' undertaking shall be proportionate to its revenues and assets at the time when the guarantee is granted, except if the guarantor's assets are sufficient to satisfy its obligations when the guarantee is called.

**Giving or taking security**

**RESTRICTIONS AS TO THE SECURED CREDITORS AND OBLIGATIONS**

Security may only be granted in favor of the person to whom the secured debt is owed.

Certain kind of security interests may only be granted in favor of certain creditors to secure certain claims. For instance, a Daily assignment may only be granted in favor of a credit institution or a financing company to secure a loan that it has granted to the assignor in the course of its business.

**PRIVATE DEED OR NOTARIAL DEED**

There are no notarization requirements for security documents under French law, except for:

- mortgage over real estate – the mortgage deed (acte d'affectation hypothécaire) has to be drawn up by a notary;
- pledge over business (nantissement de fonds de commerce), which can be either drawn up by a notary or entered into as a private deed provided that it is registered (ie stamped and filed at nominal costs) with the tax authorities; and
- pledge over shares issues by a société civile, which has to be notarized and accepted by the company or notified by bailiff (huissier) to the company whose share are being pledged.

**COMPULSORY PROVISIONS**

Some security documents (such as aircraft mortgages, mortgages over ships and Daily assignments) must contain compulsory provisions. In the absence of such provisions, the security shall be declared null and void.

**PERFECTION REQUIREMENTS**

Once granted, some security interests need to be properly perfected in order to be enforceable against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the security and notice being given to third parties.

In France, there is no general security register in which all security interests granted over assets located in France shall be registered. However, specific security interests have to be registered with the commercial register having territorial jurisdiction or, as the case may be, specific registers.

Depending upon the type of security, there may be applicable time limits for registration. In the case of non-registration within such time limits, the security interest will be unenforceable against third parties. The security interest takes priority according to the date of its registration. The registration shall remain effective for a specific period of time, but may be renewed before expiry of such period of time.

**LANGUAGE**

Security documents can be drafted in foreign languages, except when:

- drawn up by a French notary;
- registered with a French authority; or
- mandatory provisions drafted in French are required (eg a 'Daily' assignment).

_Last modified 4 Dec 2019_
Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Civil Code (Code civil), in particular Book III, Title III (Contracts), IV (Obligations’ regime) & Title X (Loan), and Book IV (Security & Guarantee)

Monetary and Financial Code (Code monétaire et financier)

Regulation of the French authorities (AMF, ACPR, Banque de France)

Consumer credit

Consumer Code (Code de la consommation), in particular Chapter IV (Consumer Credit)

Mortgages

Civil Code (Code civil), in particular article 2393 and seq.

Corporations

Commercial Code (Code de commerce), in particular Book II (Companies and other groups)

Funds and platforms

Monetary and Financial Code (Code monétaire et financier)

AMF General Regulations (Règlement Général de l'AMF)

Other key market legislation

Commercial Code (Code de commerce), in particular Book VI (Insolvency Proceedings)

Regulatory authorization

Who are the regulators?

There are two main regulators:

- the Prudential Supervisory and Resolution Authority (Autorité de contrôle prudentiel et de résolution) (ACPR), which supervises regulated entities acting in the banking, payments, investment and insurance industries (eg credit institutions, payment institutions, electronic money institutions, investment companies, digital assets service providers (DASPs), insurance firms, etc.); and

- the Financial Markets Authority (Autorité des Marchés Financiers) (AMF), which supervises and authorises participants and products in financial markets including, without purporting to be exhaustive:
  - financial markets and market infrastructures;
  - listed companies;
  - financial intermediaries authorized to provide investment services and financial investment advice (credit institutions authorized to
provide investment services, investment firms, alternative investment fund managers (AIFMs), financial investment advisors;

- alternative investment funds (AIFs);
- undertakings for collective investments in transferable securities (UCITS); and
- DASPs.

**What are the authorization requirements and process?**

Depending on the type of regulated entity (credit institution, investment firm, alternative investment fund manager (AIFM), an entity must apply to the Prudential and Resolution Supervisory Authority (Autorité de contrôle prudentiel et de résolution) (ACPR) or the Financial Markets Authority (Autorité des Marchés Financiers) (AMF) for authorization.

The regulators assess whether the application meets the required conditions such as:

- suitability of the legal form for the proposed activity;
- minimum capital requirements;
- program of operations, technical and financial resources, organization;
- identity and status of capital contributors, and where applicable, of their guarantors, and the size of their holding;
- location of the central administration and registered office;
- the activity must be effectively run by at least two people, whose knowledge, experience and fitness must be demonstrated, both individually and collectively, as well as their availability; and
- members of the governing body, persons who are in charge of effective management and persons responsible for governance procedures must meet, without purporting to be exhaustive, availability, worthiness, knowledge, skills and experience requirements, assessed both individually and collectively.

**What are the main ongoing compliance requirements?**

Authorized entities must, without purporting to be exhaustive, comply with all required conditions listed above and also with the legal and regulatory rules applicable to their activities.

**What are the penalties for failure to be authorized?**

A person undertaking a regulated activity without being authorized or exempted, commits a criminal offence and is liable to imprisonment and a fine.

**Regulated activities**

**What finance and investment activities require authorization?**

Save for certain exemptions provided for in the Monetary and Financial Code (Code monétaire et financier), any person who/which provides finance or investment services, on a regular basis, is required to be authorized by either the Prudential and Resolution Supervisory Authority (Autorité de contrôle prudentiel et de résolution) (ACPR) or the Financial Markets Authority (Autorité des Marchés Financiers) (AMF).
In particular, the following financing and investment activities require authorization from the regulators or a registration:

- banking services (including, without purporting to be exhaustive, receipt of repayable funds from the public and credit);
- payments services;
- issuance and management of electronic money;
- investment services;
- crowdfunding; and
- management or marketing of alternative investment funds (AIFs).

Banking services are subject to the banking monopoly, which especially applies to the paragraphs on giving and taking guarantees and securities below. In this respect, when transferring a loan and related security, it should be considered whether the transferor was or is duly licensed to provide a credit and whether the transferee is duly licensed (or passported) to act as a transferee.

**Are there any possible exemptions?**

Certain exemptions are available depending on the entity providing the regulated activities (such as certain public entities, etc.).

Certain exemptions are available depending of the type of activity contemplated (such as intercompany lending, loans granted by non-profit associations, etc.).

**Do any exchange controls or other restrictions on payments apply?**

Manual money changers obtain an authorisation from the Prudential Supervisory and Resolution Authority (Autorité de contrôle prudentiel et de résolution) (ACPR). Pursuant to EU and French regulations, any person which carries to a Member State of the European Union or from a Member State of the European Union more than EUR10,000 of cash shall declare that sum to the custom authorities.

Other restrictions apply related to payments and foreign investments (and divestments).

**What are the rules around financial promotions?**

The main rules regarding financial promotions are as follows.

**Banking and financial solicitation (démarchage bancaire et financier)**

Banking or financial solicitation (démarchage bancaire et financier) is strictly regulated under French law: any unsolicited contact, by whatever means, with an individual or legal entity in order to obtain its agreement to enter into a transaction for financial instruments constitutes banking or financial solicitation (démarchage bancaire et financier) (Solicitation).

The Monetary and Financial Code (Code monétaire et financier) (CMF) provides a list of entities authorized to perform Solicitation, among which are, without purporting to be exhaustive, credit institutions, electronic money institutions, payment institutions, insurance firms, investment firms and their agents, financial investment advisers, etc. Any entity carrying out Solicitation must comply with the specific regime provided in the CMF relating to information obligations, right of withdrawal, registration requirements etc.

Several exemptions to this regime are available. One of them is when the targeted persons are French ‘qualified investors’: a qualified investor is an individual or a legal entity possessing the expertise and resources required to apprehend the risks inherent in transactions in financial instruments (eg banks, financial institutions or large corporates).

Solicitation is prohibited for certain products, such as, without purporting to be exhaustive, products whose maximum risk is not known or that exceed the amount of the initial subscription made by the investor, or products unauthorized for marketing.
Information, advertisements and marketing material addressed to clients

Any information, advertisement or marketing material addressed to investment firms’ clients must be clearly identified as advertising, be accurate, clear and not misleading. In addition, the material must mention the existence of a prospectus and the key investor information document. The Financial Markets Authority (Autorité des Marchés Financiers) (AMF) may request the marketing material contents to be modified or sent to it prior to the publication. In accordance with the Markets in Financial Instruments Directive, investment firms acting in France must also provide their clients or potential clients with information that enables them to have a reasonable understanding of the nature of the investment service and the specific type of financial instrument proposed, as well as the risks associated therewith, thus enabling them to make their investment decisions in full knowledge of the facts.

The rules detailed above are not exhaustive and do not cover for instance certain specific French law provisions that may apply depending on the characteristics of the activities carried out in France (eg consumer protection rules, contract or solicitation made by electronic means, financial instruments distribution rules, rules applicable to the marketing of structured or complex financial instruments, etc.).

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

The most common types of legal entities are used to undertake financial or investment activity, such as public limited company (société anonyme) or simplified joint-stock company (société par actions simplifiées), both of which are body corporates with separate legal personality and limit the liability of their members.

Is it possible to conduct lending or investment business through a branch or establishment?

It is possible to conduct lending or investment business through a branch of an authorised European regulated entity or from an authorised European regulated entity without any physical presence in France through the so-called ‘European passport’.

Overseas companies having a French branch may conduct lending business in France subject to an authorization granted by the Prudential and Resolution Supervisory Authority (Autorité de contrôle prudentiel et de résolution) (ACPR) and compliance with specific prudential and regulatory requirements.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based
Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

**HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?**

Marketplace lending includes peer-to-peer (P2P) type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

**Blockchain, smart contracts and cryptocurrencies**

**WHAT IS BLOCKCHAIN?**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known
within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so-called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so-called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Banking Authority definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded electronically. The best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

• access to the assets or features of a particular project;
• the ability to earn rewards for various forms of participation on the platform; and
• prospective return on the investment.

Key aspects to consider will include the:

• availability and limitations on the total amount of the tokens;
• decision-making process in relation to the rules or ability to change the rules of the scheme;
• nature of the project to which the tokens relate;
• technical milestones applicable to the project;
• basis and security of underlying technology;
• amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
• quality and experience of management; and
• compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

On 22 May 2019, France has adopted an innovative legal framework (law and decree) governing initial coin offerings (ICOs), digital assets and digital assets services providers (DASPs). The entry into force of this legislation is however subject to specific rules to be published by the French financial market authority (AMF). The definition of digital assets is very broad and not limited to ICO Tokens and virtual currencies. DASPs providing the service of digital asset custody or purchase/sale of digital assets in exchange for legal tender are subject to mandatory registration with the AMF. Additionally, all DASPs may apply for an optional license.

Public offering of tokens is subject to specific rules including an optional registration (visa) with the AMF requiring the issue of a white paper made available to investors detailing, without purporting to be exhaustive, the token issuer’s project, the intended use of the funds and digital assets collected, the rights and obligations attached to the tokens, etc. The AMF publishes on its website a white list of ICOs benefiting from its visa as well as a “black list” of ICOs and DASPs not complying with the regulation.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Payment initiation service and account information service

The European Directive on payment services introduced two new types of payment services providers: payment initiation service is a service to initiate a payment order at the request of a bank account holder with respect to this account, held at another payment service provider, and account information service is an online service to provide consolidated information on one or more payment accounts held with either another payment service provider or with more than one payment service provider.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Prudential and Resolution Supervisory Authority (Autorité de contrôle prudentiel et de résolution or ACPR) and the Financial Markets Authority (Autorité des Marchés Financiers or AMF) are the supervising entities and regulators of firms providing banking and financial products and services.
A person must not carry on a regulated activity in France unless authorized or exempted. A banking or financial activity requires regulatory authorization when it is identified as a regulated activity, carried on by way of business on a regular basis in France and it does not fall within any of the available exemptions. Where FinTech products and/or applications involve banking or financial activity which requires regulatory authorization, the firms providing such products and/or applications must be authorized by the ACPR or the AMF.

**ACPR’S FINTECH INNOVATION UNIT**

The FinTech Innovation Unit is the ACPR team dedicated to FinTech and to innovative project initiators. The unit provides an interface between project initiators and the relevant ACPR departments, as well as the Bank of France (for projects regarding payment services) and the AMF (for projects regarding investment services). The ACPR considers that an innovative financial project consists of the creation of a company (‘startup style’) with a strong level of innovation and acting in one or several financial fields under ACPR’s supervision.

**AMF’S FINTECH, INNOVATION AND COMPETITIVENESS DIVISION**

The AMF’s FinTech, Innovation and Competitiveness Division assists stakeholders in analysing innovations in the investment services industry, identifying competitiveness and regulation challenges and, where applicable, evaluating the need to modify European regulations or the AMF policy. The ambition of the AMF is to develop an ecosystem that promotes FinTechs in order to make the Paris financial centre more attractive to foreign participants and facilitate the development and support of FinTechs.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**ELECTRONIC PAYMENT PLATFORMS**

Electronic payment platforms' activities are generally considered as regulated payment services activities requiring a payment institution authorization with the ACPR. Electronic payments platforms may also be authorized as lightly-supervised payment institutions if they do not exceed the threshold of an average volume of monthly payment transactions of EUR3 million. Depending on their features, such platforms may also trigger other qualifications and regulatory regimes, and notably, enter into the scope of the new “Pacte” law (dated 22 May 2019) – digital assets framework.

**PEER-TO-PEER LENDERS**

A person carries out a regulated banking activity if they provide lending or facilitate lending and borrowing between individuals or between individuals and businesses, in particular through an electronic platform, by way of business on a regular basis. Such regulated activity can be carried out if the person is authorized as a credit institution or financing company, or, if the person is registered as a crowdfunding intermediary.

**CROWDFUNDING INTERMEDIARIES**

Any person or entity proposing, through a website, to fund projects in the form of a loan with or without interest must be registered in the Banking, Insurance and Financial Intermediaries Register (ORIAS), as a crowdfunding intermediary. Crowdfunding intermediaries are subject to organizational and business conduct rules (in particular information obligations).

**Regulation of payment services**

Where a person provides payment services as a regular occupation or business activity in France, it will require authorization by the ACPR to become an authorized payment institution. Failure to obtain the required authorization is a criminal offence.

In order to become authorized by the ACPR, a payment services business will need to meet certain criteria, including in relation to its business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

PSD 2 regulation, as implemented into French law, has broaden the scope of payment service, which now extended to payment initiation and aggregation of payments.

**Money laundering regulations**
The Monetary and Financial Code (CMF), which will implement the European Union’s Fifth Money Laundering Directive by 10 January 2020, contains the legal provisions governing anti-money laundering and terrorism financing. The ACPR and AMF are responsible for supervising the compliance of regulated banking and financial entities with anti-money laundering requirements.

The CMF expressly includes platforms facilitating the trade of virtual currencies under the scope of the anti-money laundering legal and regulatory framework.

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**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

**Senior bank debt**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

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**Portfolio sales**
Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are as follows.

Transfer of contract (cession de contrat)

A cession de contrat is a full legal transfer of the party’s rights and obligations. It is a tripartite arrangement between the transferor (cédant), the assigned party (céde) and the transferee (cessionnaire). To the extent the assigned party (céde) has given its consent, the transferor (cédant) is released from its obligations for the future.

Assignment of rights (cession de créance)

A cession de créance is available to the extent the facility has been fully drawn. Subject to any contractual restrictions, a cession de créance can be done without the consent of the debtor.

Sub-participation

A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

What are the main considerations when transferring a loan and related security?

The main considerations in connection with a transfer of loan include:

• consent/notification – whether a transfer requires the consent or notification of any other parties;

• lender eligibility – whether there are any restrictions around the type of entity to which the loan can be transferred;

• undrawn commitments – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

• confidentiality and banking secrecy – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser; and

• data protection – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

From a general point of view, infrastructure and energy infrastructure assets in France are mostly owned by the state or the relevant public entity.
Energy

The gas and electricity industries in France have been partially privatized (EDF-GDF).

Onshore wind farms, offshore wind farms and photovoltaic plants are owned by the private companies in charge of the projects, not by public entities.

The energy sector is regulated by an independent administrative authority entitled Commission de Régulation de l’Énergie (CRE).

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in France are privately owned by a number of service providers (Orange, Bouygues, SFR and Free).

The telecom sector is regulated by an independent administrative authority entitled Autorité de Régulation des Communications Electroniques et des Postes (ARCEP).

Transport infrastructure

RAIL

Railway infrastructure is owned by SNCF Réseau, a public entity managing the railway infrastructure.

The railway sector is regulated by an independent administrative authority entitled Autorité de Régulation des Activités Ferrovières et Routières (ARAFER).

HIGHWAYS

Highways are owned by the state and concessions have been granted to private companies.

The highways sector is regulated by the ARAFER.

AVIATION

Airports are owned by public entities (State or local public entities), who have generally granted a concession. Concessionnaires were initially state-owned entities, but French law now provides for a progressive opening of the share capital of the concessionnaires to the private sector.

The aviation sector is regulated by the Direction Générale de l’Aviation Civile (DGAC).

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

These assets are owned by the relevant public entities in France. Generally, a contractor is in charge of the construction or the maintenance of these assets pursuant to a public-private partnership.

Are there special rules for investing in energy and infrastructure?

There is no specific regime governing or restricting investment in energy or infrastructure projects in France, subject to:

- antitrust clearance;
- prior authorization of the Minister of the Economy in case of foreign investments in activities in relation to materials, products or performance of services, including activities in relation to the safety and well-functioning of the installations and equipment, essentials to the guarantee of the country’s interest on public policy, public security or national defense (eg supplying electricity, gas or public health); and
What is the applicable procurement process?

Generally

The key principles of the public procurement are that:

- contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality; and
- all potential bidders are treated equally.

Different forms of public procurement exist, depending on:

- the type of administrative contract (marché public or délégation de service public ou concession);
- the nature of the project (eg PPP or renewable energy project); and
- the procurement threshold.

Legal framework of the public procurement in France

Public procurement for PPP in France is mostly based on the following European directives:

- Directive n°2014/23/UE regarding concession agreements (implemented in France by ordinance n°2016-65 and decree n°2016-86); and

Public procurement for renewable energy in France is mostly based on the following texts:

- Directive n°2009/28; and
- Law n°2015-992 and its implementing decrees issued or to be issued.

Publicity of the public procurement

This legislation is complex and depends on:

- whether it is a public procurement contract or a concession; and
- some thresholds applicable to this type of procurement and contract.

Form of public procurement

For greenfield projects (ie when the asset has not been commissioned yet), the public procurement is complex.

For public procurement contracts:

- below a certain threshold there is an adapted bidding process (marché à procédure adaptée) in which the public entity determines freely the modalities of the procedure; or
- above a certain threshold there is formalised procedure (procédure formalisée) in which the public entity shall run one of the following procedures:
  - tender process (appel d'offres), which may be opened (ie any bidder may apply) or restricted (ie a few bidders may apply);
  - competitive procedure with negotiation (procédure concurrentielle avec négociation) in which the public entity may negotiate the
conditions of the public procurement contracts with one or several bidders, after receipt of the initial offer;

- negotiated procedure with prior call of competition (procédure négociée avec mise en concurrence préalable) in which the public entity may negotiate the conditions of the public procurement contracts with one or several bidders, before receipt of the initial offer; or

- competitive dialogue (dialogue compétitif) in which the public entity cannot set out the technical, financial or legal means for the project.

For concession agreements:

- the public entity freely organizes the procurement procedure;

- the minimal procedural guarantees (garanties procédurales minimales) shall be complied with by the public entity for any concession agreements; and

- in addition to the common rules set out for the concession agreements, sectoral rules (for example in relation to hydroelectric, highway or ski lift concession) and specific rules depending on the amount of the concession agreement or its purposes shall apply.

For renewable energy (for example), in the offshore wind, onshore wind and photovoltaic sectors, a tender process shall be complied with for projects exceeding a certain threshold.

For a brownfield investment (ie when the asset has already been commissioned), contractual mechanisms inserted in the public contract (or in the relevant finance documents) control the shareholding structure of the special purpose vehicle (SPV).

Financing in the context of a public procurement

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. In any case, size and costs of the debt financing play an important role in the decision of the awarding public entity.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in France (including in relation to public-private partnerships) are:

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a project-finance basis (to a special purpose project company) without any recourse against the shareholders of the special purpose vehicle (SPV) (these loans are generally a bridge loan for the construction and VAT, and at the commissioning, a refinancing loan in order to reduce the financing costs (as the asset has been delivered));

- projects bonds in the context of a refinancing;

- mezzanine debt provided by funds to the holding company of the SPV; and

- asset financing (which is particularly relevant in the rail, aviation and maritime sector).

The European Investment Bank is very active in telecom and infrastructure from a general point of view, while export credit agencies are more focused on assets (such as aircraft or ships).

Distressed funds may also acquire some debt participation through one of the mechanisms described in Loan transfers and portfolio sales. In addition, French law has recently authorized certain kind of funds to lend directly to borrowers (professional private equity fund (FPCI), private equity funds (FPS and SLP), financing entities, which includes securitisation entities and specialised financing entities (OFS and SFS).

Investing
Common forms of investing in energy and infrastructure include:

- equity participation in the SPV, shares, convertible bonds etc; and
- shareholders loans (subordinated to the rights of the lenders in the context of a project financing).

It is specified that a private entity and a public entity may own some companies operating an asset in certain areas, called sociétés d'économie mixte.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Prudential and Resolution Supervisory Authority (Autorité de contrôle prudentiel et de résolution) (ACPR) or the Financial Markets Authority (Autorité des Marchés Financiers) (AMF) considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

What regulatory penalties may apply?

When a rule breach has taken place, the Prudential and Resolution Supervisory Authority (Autorité de contrôle prudentiel et de résolution) (ACPR) or the Financial Markets Authority (Autorité des Marchés Financiers) (AMF) may impose a penalty (up to EUR100 million or to 10% of net annual turnover for legal persons, and EUR 5 million or tenfold the amount of the benefit derived from the breach for natural persons for the ACPR, and up to EUR 100 million or to 10 times any profit earned for professional under AMF supervision or up to EUR 300,000 or to 5 times any profit earned for individual acting under the authority or on behalf of a professional, for the AMF) or censure, or withdraw regulated status (on a temporary or definitive basis) against the firm and/or regulated individuals. Regulators may also require inter alia the compulsory resignation of the regulated entities directors. The regulator will publicize these penalties.

The ECB has competence to pronounce sanctions as well against French entities subject to its direct supervision.

What criminal penalties may apply?

Following formal judicial proceedings, French courts have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the Money Laundering Regulations;
- conducting regulated activities when not authorized; or
- any other breach of applicable rule such as prudential, good conduct rules, etc.

Tax

Tax issues
**Are stamp, registration, transfer or other similar taxes applicable?**

**Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?**

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan, unless the parties voluntarily register the agreement in relation to the loan before the French tax authorities. In this case, the registration fee amounts to €125.

**Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

The constitution of a conventional mortgage (hypothèque conventionnelle) over real estate must be entered into by notarial deed and executed in front of a French public notary. It gives rise to (i) notary fees and (ii) land registration tax (taxe de publicité foncière) at a global rate of 0.71498% calculated on the amount guaranteed by the mortgage plus a real estate contribution (contribution de sécurité immobilière) at a rate of 0.05% calculated on the amount guaranteed.

The assignment of the beneficiary right under a conventional mortgage (subrogation d'hypothèque) gives rise to (i) notary fees and (ii) a real estate contribution (contribution de sécurité immobilière) at a rate of 0.05% calculated on the amount of the assigned mortgage.

Under French law, the question as to whether the taking or the transfer of a security interest must be registered is dependent on the type of security. Certain security interests (e.g., a pledge over ongoing business assets or share pledge with respect to shares in civil companies) must be registered in a special registry kept by the clerk of the commercial court (Tribunal de commerce) and are subject to registration fees. In any case, the parties may voluntarily register the agreement in relation to the taking or the transfer/assignment of security before the French tax authorities. In this case, the registration fee amounts to €125.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g., a bond)?**

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security (e.g., a bond), unless the parties voluntarily register the agreement in relation to the debt security before the French tax authorities. In this case, the registration fee amounts to €125.

**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g., secured bond holders)?

The French Public Treasury has a general privilege to ensure the collection of the main taxes (e.g., corporation tax and value added tax).

Determining the ranking between the French Public Treasury and secured lenders or secured debt security holders is a complex issue. Indeed, rules regarding priority on enforcement vary depending on the type of security, the creditor and the situation of the debtor (insolvent or not insolvent).

In insolvency cases, for example, French insolvency law provides for a set waterfall of payments for unsecured assets (sale of assets or business within the frame of safeguard, receivership, or liquidation proceedings) that is as follows:

- the employees’ super priority (wages and paid holidays due to employees for the last 60 days preceding the opening of the insolvency proceedings);
- court expenses and legal professional fees;
- new money facilities granted during conciliation proceedings;
- claims arising after the opening of the insolvency proceedings to the benefit of the proceedings (including taxes arising after the
opening of the proceedings);

- claims secured by real property or by a security interest including a right of retention or pledge on professional machinery and equipment (including any tax claim that have been converted into a security on real estate or machinery);
- other privileged or secured pre-judgment claims; and
- other pre-opening unsecured claims.

The secured lenders take priority over other creditors on any sale of collateral over which their security has been taken (it has to be noted that tax claims can be converted into security before the opening of the proceedings and therefore the tax authorities could be treated as a secured creditor).

In conclusion, the position of the tax authorities compared to secured lenders and secured debt security holders in the context of insolvency proceedings depends on the nature of the tax claim and whether or not the tax claim has been converted into security with collateral before the opening of the insolvency proceedings.

**Is withholding tax on interest payments applicable?**

**Is there withholding tax on interest payments under a loan?**

As a general rule, no withholding tax is levied on French source interest payments, except in cases where:

- interest is paid to a beneficiary or to an account, located in a non-cooperative state or territory (NCST); or
- the interest payment is not deductible for the debtor by virtue of the application of the French rules which in some cases may limit the deduction of interest to the maximum legal interest rate provided for by Article 39.1.3° of the French tax code. In these cases, the non-deductible interest is reclassified as a deemed dividend subject to dividend withholding tax.

If so:

**What is the rate of withholding?**

Interest paid under a loan by a French entity to a beneficiary located in a NCST or to an account located in a NCST may be subject to withholding tax at a rate of 75%, unless the recipient is able to prove that the payments do not have a tax avoidance motive.

The standard withholding tax rate on dividends is currently 30% (to be progressively reduced down to 25% in 2022). This rate applies to deemed dividends (see above). The rate may be reduced or the withholding tax eliminated under an applicable double tax treaty.

**What are the key exemptions?**

There is generally no withholding tax on interest, except for the specific circumstances described above.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.
Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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Key contacts

Maud Manon
Partner
DLA Piper France LLP
maud.manon@dlapiper.com
T: +33 1 40 15 24 00
Germany

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

German debt securities are predominantly bearer bonds. Issuing bearer bonds does not require any permission and, in particular, does not constitute deposit taking. Raising moneys on the basis of German law registered bonds (Namensschuldverschreibungen) may constitute deposit taking and may require a banking license.

What are common issuing methods and types of debt securities?

Debt securities are issued either directly or through underwriters purchasing the securities and distributing them to investors. Debt securities may be issued on a stand-alone basis or under a program.

Types of securities include corporate bonds, hybrid bonds (for rating or regulatory capital purposes), convertibles, exchangeables, high yield bonds and a large variety of structured notes (including warrants).

What are the differences between offering debt securities to institutional / professional or other investors?

The issuance of unlisted notes to professional investors does not trigger a prospectus requirement while public offers of unlisted notes to retail investors requires the publication of a prospectus. Prospectuses for retail offers are typically based on a special format (the German retail format) containing integrated or consolidated German language terms and conditions.

When is it necessary to prepare a prospectus?

It is necessary to prepare a prospectus in the case of non-exempted public offers and listings.

What are the main exchanges available?
The main securities exchange is the Frankfurt Securities Exchange operated by Deutsche Börse AG. The Stuttgart stock exchange is important for structured notes.

Is there a private placement market?

There is a very active private placement market. Debt instruments in this market are primarily German law Schuldscheine (debt certificates) and German law registered notes (Namensschuldverschreibungen).

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

There are no unusual jurisdiction-specific legal risks.

Investing in debt securities

There are no unusual jurisdiction-specific legal risks.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Establishing a fund is regulated under the German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB).

What are common fund structures?

Common form of funds include:

- Undertakings for Collective Investments in Transferrable Securities (UCITS); and
- Alternative Investment Funds (AIFs).

What are the differences between offering fund securities to professional / institutional or other investors?

A different set of rules apply under the German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB) depending on whether you are marketing funds to retail investors or to professional/semi-professional investors. For all types of investors the marketing of a fund must be notified to and approved by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)). When marketing to retail investors the fund managers generally need to provide the retail investor with more comprehensive information regarding the fund. There are specific rules as to the protection of retail investors, such as the right of revocation in certain scenarios.
Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Establishing a fund is regulated under the German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB). Managing investments is a regulated activity under the KAGB and therefore subject to authorization – pursuant to Section 339 KAGB providing the services of a fund manager without being authorized is a criminal offence punishable by imprisonment of up to five years.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Yes. The marketing must comply with the detailed marketing rules set out in the German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB). Generally, there are different rules with regard to the marketing of funds depending in particular on the type of fund, the type of investors and the domicile of the fund/fund manager.

Are there any restrictions on managing a fund?

Yes. Alternative Investment Fund Managers (AIFMs) managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to regulation under the Capital Investment Code and must generally be authorized by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin).

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Yes. Derivatives contracts are considered financial instruments under the German Banking Act (Kreditwesengesetz – KWG). Any person dealing in financial instruments can be subject to prior authorization by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)) if such activity qualifies as banking business or a financial service.

The European Market Infrastructure Regulation (EMIR) generally applies to 'over-the-counter' derivative transactions (OTC-transactions) and requires that certain transactions are to be reported to the regulators and for transactions between counterparties to be cleared. Please note: The reporting obligation under Article 9 EMIR applies to all derivative transactions, regardless of whether the transaction is an OTC-transaction or a transaction carried out on an exchange venue.

What are common types of derivatives?

Types of derivative contracts that are used in Germany include, among others:

- forwards;
• futures;
• swaps (such as interest rate or currency swaps); and
• options (call options and put options).
borrower’s note (i.e. Schuldschein) as documentary evidence of the loan debt is usually issued. Schuldscheindarlehen are exempt from the obligation to publish a prospectus under European prospectus law. They enable borrowers to gain access to institutional capital markets investors that usually cannot be reached via other bank financings. See the LMA Schuldschein Product Guide published by the Loan Market Association (LMA) for more information.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending to consumers is a regulated activity and subject to special requirements for consumer credit agreements pursuant to section 491 et seq. of the German Civil Code (Bürgerliches Gesetzbuch – BGB), regarding, for example, the written form, minimum content, information obligations of the lender and right of withdrawal of the borrower.

Do the laws recognize the principles of agency and trusts?

The principle of agency is recognized under German law. For instance, it is possible to appoint an agent to act on behalf of other parties.

The English common law concept of trust is not recognized as a matter of German law. However, the same effect of a trust is achieved through the use of a similar German law legal instrument, namely a Treuhand which creates a contractual fiduciary relationship. Hence, in a finance transaction the security can be held by a security agent for the benefit of the secured parties as trustee under German law (Sicherheitentreuhänder) on similar conditions as a English common law trust. Particular provisions are required with respect to accessory security interests. (For more information, see Giving and taking guarantees and security.) Please note that, in order to minimize insolvency
risks, the payment streams have to be checked on a case-by-case basis as the German Sicherungstreuhand does not, in contrast to an English common law trust, create a separate legal estate.

Are there any notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles, such as:

- the general civil law principle of good faith (Treu und Glauben);
- the general civil law principle prohibiting violation of good morals (gute Sitten);
- usury (Wucher); and
- the prohibition of compound interest (Zinseszinsverbot) under German law.

Standard form documentation

Most German law syndicated finance transactions are governed by documentation based on the German law versions of the recommended forms published by the Loan Market Association (LMA) in the English language. Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house in German language. Sometimes, the standard documentation developed by the Association of German Banks (Bundesverband der deutschen Banken) is used.

Are there any notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Insolvency

Under German insolvency laws the fulfilment of a debt, the granting of collateral or enabling a counterparty to obtain such fulfilment or collateral may be contested by the insolvency administrator if the guarantee or security was granted by a company within certain periods of time (suspect periods) prior to the filing of insolvency proceedings against such company. This would be the case if, for example, the granting of collateral was made during the three months prior to the request to open insolvency proceedings, the company was illiquid on the date of the transaction, or the creditor was aware of his insolvency on this date (section 130 of the German Insolvency Act (}
Awareness of circumstances indicating insolvency or to a request to open insolvency proceedings are deemed equivalent to awareness of insolvency or of the request to open insolvency proceedings. Guarantees and security may also be challenged on other grounds relating to insolvency. Outside of insolvency proceedings, transactions and payments of the company may be contested by creditors under the Avoidance of Transactions Act (Gesetz über die Anfechtung von Rechtshandlungen eines Schuldners außerhalb des Insolvenzverfahrens – AnG) which provides rights to creditors similar to those of an insolvency administrator in insolvency proceedings.

Financial assistance/upstream security

Pursuant to German statutory law on capital maintenance requirements, a limited liability company (Gesellschaft mit beschränkter Haftung – GmbH) may, in general terms, only grant upstream security to its shareholders to the extent it has free reserves in its balance sheet. Free reserves are roughly equal to the total assets minus total liabilities and provisions, minus stated share capital. The principle also applies to the general partner in a partnership in the form of a GmbH and Co. KG. A stock corporation (Aktiengesellschaft – AG) may not grant upstream security at all. Exemptions apply under domination and profit transfer agreements and to payments which are covered by a full claim to counterperformance or restitution against the shareholder. In order to achieve compliance with the relevant statutory law, so called 'limitation language' has to be introduced in the relevant finance documentation.

Accessory security interests

Accessory security interests that depend on the existence of the underlying secured claim, such as guarantees and pledges must be granted to and held by each secured creditor and are automatically terminated and released by operation of mandatory German law upon satisfaction of the underlying secured claim. This can be an issue in certain cases, for example syndicated loans or, in case of the transfer of a lender’s rights and obligations under a loan agreement, by way of novation. For such cases parallel debt structures have been established by the market.

Parallel debt structure

Non-accessory security interests (that exist irrespective of a secured claim, such as security assignment, security transfer or land charge) can be held by a security agent for the benefit of the secured parties as trustee under German law (Sicherheitentreuhänder). For more information, see Lending and borrowing.

With respect to accessory security interests, such as guarantees and pledges, the standard technique used for sharing security between various creditors under syndicated loans is by the use of a parallel debt structure. With this structure, a second claim is created for the benefit of the security agent as an abstract acknowledgment of debt in the amount of the original payment obligations under the loan agreement (Parallel Debt). As the creditor of the Parallel Debt, the security agent can then hold and administer the accessory security. Provisions in an inter-creditor agreement or collateral agency agreement usually stipulate that the security agent acts on the instructions of the other secured parties. Please note that, although the Parallel Debt structure is commonly used in the market and generally accepted in German legal doctrine, its validity has never been tested by the German courts.

Floating charges

The concept of a floating charge is not recognized as a matter of German law.

What are common types of guarantees and security?

Common forms of guarantees

Guarantees may take the form of a performance guarantee or a payment guarantee. The most common form in finance transactions is the payment guarantee.

German law further distinguishes between an accessory guarantee and an independent (non-accessory) guarantee, such as payment guarantees upon first demand. German courts held that, to be valid, a guarantee upon first demand needs to be granted by a guarantor experienced in international transactions and familiar with guarantees upon first demand. This is due to the fact that a guarantor giving a guarantee upon first demand has only limited defenses, for example the objection of abuse of law. In contrast, a guarantor who gives an accessory guarantee may rely on the defenses to which the principal debtor is entitled.
Common forms of security

The security package which is granted for financings mainly depends on the financed asset and the specific transaction. Typically, the following security interests are requested by the lenders:

SHARE/INTEREST PLEDGE

A pledge of shares in a German limited liability company (Gesellschaft mit beschränkter Haftung – GmbH) requires notarization whereas a pledge over interests in a limited partnership (Kommanditgesellschaft – KG) can be entered into in simple written form. A pledge over shares in a stock corporation (Aktiengesellschaft – AG) may also be completed without observing specific formalities; only the share certificates issued for the relevant shares need to be transferred to the pledgee. The notification of the relevant company/partnership is not required for the perfection of the security. However, the articles of association of a company may provide for the requirement of the company's approval. As an accessory security interest, the share/interest pledge must be granted to and held by each secured creditor. Therefore, a parallel debt structure is usually implemented in syndicated financings. For more information, see Lending and borrowing.

BANK ACCOUNT PLEDGE

The notification of the account bank is required for the perfection of the security. The account bank usually has a first ranking pledge pursuant to its general business terms; if the lending bank wishes to obtain a first ranking security, the account bank then may be asked to waive/subordinate its rights pursuant to its general business terms. Security must be granted to and held by each secured creditor. Therefore, a parallel debt structure is usually introduced in syndicated financings. For more information, see Lending and borrowing.

SECURITY ASSIGNMENT OF RECEIVABLES AND CLAIMS

Unless disclosed to the debtors of the assigned receivables (third party debtors), the debtor may continue to pay with discharging effect to the assignor. The notification of the assignment is no perfection requirement, but common where there are only a small number of third party debtors (eg with respect to claims under insurance agreements).

SECURITY TRANSFER OF MOVEABLE ASSETS (SUCH AS INVENTORY AND EQUIPMENT)

It is very important to describe the assets precisely, for example by using maps or serial numbers, in order to ensure their determinability when acquired (particularly in relation to future assets) or enforced. Typically, the specification of transferred assets is done by a combination of describing the area where the assets are located and by delivery of a list of the relevant assets. If the assets are fixtures (ie they relate to the relevant premises in such a way that they cannot be legally separated from the premises) then land security should be obtained.

MORTGAGE OR LAND CHARGE OVER LAND AND BUILDINGS

A mortgage or land charge must be created by notarized deed. In addition, the registration of the mortgage or land charge in the relevant land register (Grundbuch) is required for its effectiveness. The notary and registration fees depend on the nominal amount and may be significant.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

In order to be valid, a guarantee upon first demand must be granted by a guarantor experienced in international transactions and familiar with guarantees upon first demand. This is because the guarantor of a guarantee upon first demand has only limited defenses. For more information, see Giving and taking guarantees and security – common types.

Giving or taking security

NOTARIZATION REQUIREMENTS
The following security interests require notarization under German law:

- a pledge over shares in a German limited liability company; and
- the creation of a mortgage or land charge.

REGISTRATION REQUIREMENTS

A mortgage or land charge must be registered in the relevant land register (Grundbuch) to become valid.

INITIAL AND SUBSEQUENT OVER-COLLATERALIZATION

In case of an initial disproportionate relationship between the value of the granted security and the secured claims (initial over-collateralization), the agreement creating such security may be invalid. If, after the conclusion of the agreement (subsequent over-collateralization), the value of the security exceeds 110% of the secured claims, the grantor may have a claim for release of the excess security.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

- German Banking Act (Kreditwesengesetz – KWG)
- Securities Trading Act (Wertpapierhandelsgesetz – WpHG)
- Payment Services Supervision Act (Zahlungsdienstaufsichtsgesetz – ZAG)

Consumer credit

- German Civil Code (Bürgerliches Gesetzbuch – BGB)
- Introductory Act to the Civil Code (Einführungsgesetz zum Bürgerlichen Gesetzbuche – EGBGB)

Mortgages

- German Civil Code (Bürgerliches Gesetzbuch – BGB)

Corporations

- Stock Corporation Act (Aktiengesetz – AktG)
- Limited Liability Companies Act (Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG)
- Commercial Code (Handelsgesetzbuch – HGB)

Funds and platforms

- German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB)

Other key market legislation

- Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)
- Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)
- European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)
Regulatory authorization

Who are the regulators?

The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – (BaFin)) and the Deutsche Bundesbank share banking supervision in Germany.

Pursuant to Section 6 para 1 of the German Banking Act (Kreditwesengesetz (KWG)), BaFin is the administrative authority responsible for the supervision of institutions under the Banking Act. The cooperation between BaFin and the Deutsche Bundesbank is governed by Section 7 of the German Banking Act (Kreditwesengesetz (KWG)), which stipulates that, among other things, the Deutsche Bundesbank shall, as part of the ongoing supervision process, analyze the reports and returns that institutions have to submit on a regular basis and assess whether their capital and risk management procedures are adequate.

What are the authorization requirements and process?

A firm must apply for authorization to the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – (BaFin)). The BaFin will assess whether a firm meets the requirements set out in the German Banking Act (Kreditwesengesetz – KWG) including, for example capital requirements and organizational requirements.

The BaFin must assess the application within a period of six months from the submission of the complete application for authorization.

What are the main ongoing compliance requirements?

Threshold conditions, such as having adequate financial resources and compliance arrangements in place, are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules may result in sanctions for firms and regulated individuals, and loss of regulated status.

What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment of up to five years.

Regulated activities

What finance and investment activities require authorization?

Generally

A person must not carry on a regulated activity in Germany unless authorized or exempt.
A financial activity generally requires regulatory authorization when it either qualifies as banking business (e.g., deposit-taking business) or the provision of financial services (e.g., the provision of investment advice).

**Consumer credit**

Credit business generally qualifies as licensable banking business and requires prior authorization by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin).

*Last modified 20 Oct 2017*

**Are there any possible exemptions?**

Activities that are otherwise regulated may be undertaken without authorization if general or specific exemptions are available.

**General exclusions**

Certain persons may carry on a regulated activity without being authorized if they are granted an exemption granted by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)).

**Specific exclusions**

For certain types of regulated activities specific exemptions can apply, for example:

- for undertakings whose sole financial service within the meaning of section 1 para 1a sentence 2 of the German Banking Act (Kreditwesengesetz – KWG) comprises carrying out financial leasing activities, if they act only as an asset-leasing vehicle for a single leased asset, do not make their own business policy decisions and are managed by an institution domiciled in an EEA state which is authorized to conduct financial leasing operations under the laws of the home member state; and

- for undertakings whose sole financial service within the meaning of section 1 (1a) sentence 2 of the German Banking Act (Kreditwesengesetz – KWG) is dealing in foreign notes and coins, unless their principal activity is foreign currency dealing.

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**Do any exchange controls or other restrictions on payments apply?**

Compliance with the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung – AWV) must be ensured.

Where money is being transferred from non-EU member states, imports of foreign currency may need to be declared in customs declarations.

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**What are the rules around financial promotions?**

Financial promotions of banks or investment firms must comply with the rules set out in the German Banking Act (Kreditwesengesetz KWG) and the Securities Trading Act (Wertpapierhandelsgesetz – WpHG).

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**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

Banks and financial services providers are usually established as German entities in the form of a private company limited by shares (Gesellschaft mit beschränkter Haftung – GmbH) or a public company limited by shares (Aktiengesellschaft – AG) and, in some cases, as a...
limited liability partnership (GmbH and Co KG).

To the extent Special Purpose Vehicles are set up for a certain transaction, they are usually established as a GmbH or a GmbH and Co KG.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

Firms authorized by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)) in Germany can establish branches in Germany.

Certain firms that are authorized in other EEA-member states may rely on the European passport regime when establishing a branch in Germany.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Blockchain

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

Smart contracts

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain.
network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as 'robo advisers', are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters.

**Cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection.

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht or BaFin), and the Deutsche Bundesbank are the regulatory authorities in Germany with respect to firms providing banking or financial products and services.

A person must not carry out a regulated activity in Germany unless authorized or exempt under the German Banking Act or the Payment Services Supervision Act. Where FinTech products or applications involve any financial activity which requires regulatory authorization, the firms providing such products or applications must obtain such authorization prior to commencing their regulated business activity. Carrying out regulated activities without the necessary authorization is a criminal offence.

The BaFin has published guidance for FinTech companies, in particular as to the question of whether certain business activities (eg crowdlending, crowdinvesting or robo advice) require a license in Germany.

**Banks and financial services providers**

Any FinTech provider that either conducts banking business or provides financial services must obtain a prior written authorization under the German Banking Act.

**Regulation of payment services**

Payment services providers are regulated under the Payment Services Supervision Act and require a prior written authorization by the BaFin for carrying out payment services.

**Application of data protection and consumer laws**

FinTechs dealing with consumers must comply with all relevant consumer protection laws (eg in relation to information obligations). FinTechs must also comply with the applicable data protection legislation, in particular if they come in contact with any personal data.

**Money laundering regulations**
Generally, where a firm is authorized as either a financial institution or a payment services provider it will need to comply with the regulations on money laundering, in particular with the requirements set out in the German Money Laundering Act.

*Last modified 20 Oct 2017*

**What type of funding arrangements and incentives are available to FinTech businesses?**

There are numerous options available to FinTechs with respect to funding their businesses, including the following.

**Crowdfunding**

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

**Venture capital**

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies. VC provides an alternative to traditional lending in particular in scenarios where the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

**Bank debt**

Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**Capital markets funding**

An Initial Public Offering (IPO) can be a viable option for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange.

FinTech companies can also issue bonds to investors as a way of raising more competitive funding.

*Last modified 20 Oct 2017*

**Portfolio sales**

**Loan transfers and portfolio sales**

**What are common ways of buying and selling loans?**

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling and transferring loans are:

- **Assignment and Assumption of Contract (Vertragsübernahme)** – A Vertragsübernahme is a full legal transfer of a party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a continuation of the existing contract between the continuing party and the transferee and the transferor being released from its obligations.

- **Assignment** – An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. Assignments may be done on a silent basis or on a disclosed basis. If disclosed, payments by the debtor to the assignee have releasing effect.
Sub-participation – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Loan transfers are commonly documented using standard form contracts in Germany based on the Federal Association of Loan Purchase and Servicing (Bundesvereinigung Kreditankauf und Servicing e.V. – BKS) standards. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **Assignability** – whether the loans and security can be transferred or are subject to contractual or legal restrictions;
- **Registration of land charges** – whether land charges (if this type of security is part of the security package) are duly registered and serve the correct security purpose;
- **Parallel debt** – if the loan and security can be independently demanded by a security trustee, whether a valid parallel debt structure is in place that secures accessory security against extinguishment if transfers of the loan have to be made under a different jurisdiction’s law, for example novation under English law;
- **Confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **Data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **Lender eligibility** – whether there are any restrictions regarding the type of entity to which the loan can be transferred;
- **Undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **Transfer mechanics** – whether there are any steps required to be taken in order to transfer the loan in accordance with its terms; and
- **Consent** – whether a transfer requires the consent or notification of any other parties.

Projects

Financing / investing in energy / infrastructure

**To what extent are energy and infrastructure assets publicly or privately owned?**

The gas and electricity industries in Germany are privatized, with the generation/production, transmission, distribution and supply provided by various private sector companies. Accordingly, relevant infrastructure assets used for generation/production, transmission and distribution are owned by private sector companies. However, at a regional level, municipal utilities (such as public law companies or private law entities in majority held by municipalities) may provide utility services under a public service mission and therefore may also own energy infrastructure assets.

Motorways and roads are almost exclusively owned by the state, either by the Federal Republic of Germany (eg the motorways), or the relevant Bundesländer, municipal entities etc. Very few roads are privately owned. The same is true for other traffic assets (tunnels etc).

The major German rail company, Deutsche Bahn, is organized as a stock exchange company, but all stock is held by the Federal Republic of Germany. Other smaller rail companies exist which are, however, private entities.
Are there special rules for investing in energy and infrastructure?

Energy and infrastructure markets in Germany are highly regulated by European and national legislation and also by decisions of the German regulatory authority, the German Federal Network Agency (Bundesnetzagentur). This especially holds true for the operation of electricity or gas networks. In particular, network operators are not entitled to freely determine tariffs for the transportation of energy but need to comply with regulatory requirements relating to tariffs (which will, however, still provide for considerable incentives for investments). Accordingly, investors will need to have a good understanding of the applicable regulatory framework and, due to regularly changes to the regulatory framework, will also need to take into account potential directions in which the market may move.

Investors will also need to be aware that energy markets are subject to a complex system of contractual arrangements between generators/producers/importers, suppliers, purchasers, network and storage operators and also the relevant person conducting balancing services for the injection of energy in the network and the withdrawal from the network. The contractual agreements in relation to network access are highly regulated and therefore will generally not leave much room for negotiation between market participants.

Furthermore, under European and national unbundling provisions effective separations of networks from activities of generation/production and supply of energy are required in order to avoid discriminatory effects. Accordingly, where an investor is already active in the area of generation/production or supply, he will only be able to invest in network facilities in compliance with strict unbundling provisions and vice versa.

Various other regulatory provisions and limitations exist for other infrastructure assets, such as telecom assets or roads.

Where essential security interests of the Federal Republic of Germany would be affected by the acquisition of the shares of a German entity or infrastructure assets, a foreign investor would also need to take into account statutory requirements under the German Federal Act on Foreign Trade (Außenwirtschaftsgesetz – AWG). In particular, such acquisition may be subject to notification requirements and the objection of German authorities.

What is the applicable procurement process?

Public procurement in Germany is governed by a variety of federal acts based on a triad of EU Directives which were modernized in 2014. On 18 April 2016, the modernized European procurement law was enacted into German law and has, in some respects, brought material changes. In relation to energy and infrastructure, the Regulation on the Award of Public Contracts (Vergabeverordnung – VgV) and the Regulation on the Award of Contracts in the field of Sectors (Sektorenverordnung – SektVO) apply. Whereas the VgV is more general in nature and therefore contains provisions for procurements not being addressed by the SektVO, the SektVO provides specific regulations for contracts in the water, electricity, energy and transportation sectors. Furthermore, there are special statutes on procurement of concessions, construction services and defense and security-related contracts.

The key principles of German procurement law are that all contracts procured by the public sector or other so-called contracting authorities are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

Investing in energy and infrastructure

Public procurement is relevant where a German contracting authority, such as the government or a sector entity, is seeking to outsource the delivery of a new project. For infrastructure projects, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal, which could include: design; building; operation; maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies not only to certain public bodies including central government departments and local authorities but also to various non-governmental bodies, such as private entities in the various sectors. A regulated procurement is required where certain financial thresholds are met and in most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met and therefore a regulated procurement would be necessary.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures:

- Open procedure – This is suitable for easy-to-evaluate projects. Tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.
• **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage. Tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

• **Negotiated procedure with prior call for competition** – In negotiated procedures with prior call for competition, any economic operator may submit a request to participate in response to a call for competition. Only those economic operators invited by the contracting entity following its assessment of the information provided may participate in the negotiations. This is a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation are not allowed following final tender.

• **Competitive dialogue** – The competitive dialogue involves a shortlisting of at least three bidders who are invited to enter into dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer’s bid.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the originally awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest in or variation to the existing project may have procurement-related considerations that need to be borne in mind since they might cause a new procurement procedure.

**Financing energy and infrastructure**

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, in project finance deals, a refinancing of the senior debt will require the consent of the public sector.

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**What are the most common forms of funding / investing in energy and infrastructure?**

As various regulatory restrictions exist, investing into the equity of an energy or infrastructure project may require in depth legal regulatory advice. Beyond these particularities, funding and investing in energy and infrastructure in Germany follows the European standard:

**Funding**

Common forms of funding in energy and infrastructure include:

• loans made on a corporate finance basis (balance sheet debt);

• loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;

• bond finance (less common in Germany than in the UK, but could become more popular in the future);

• mezzanine debt (rarely seen since the financial crisis, but in theory an alternative);

• refinancing of the debt in operational projects; and

• asset financing (this is particularly relevant in the rail sector).

Following the global financial crisis, the German government has tried to expand the funding base and increase liquidity in the market by increasing the KfW funding program for renewable energy projects with a German element to them.

Funding provided by the European Investment Bank and export credit agencies is also very popular in the German market.

**Investing**

Common forms of investing in energy and infrastructure include:
• ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and

• secondary market investment in operational projects (acquisition of ‘equity’).

Restructuring

Enforcement and sanctions

**When can there be regulatory investigations?**

The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) can – without any particular reason – perform statutory audits.

**What regulatory penalties may apply?**

Failure to comply with the requirements of the German Banking Act (Kreditwesengesetz – KWG) and other regulatory rules may result in sanctions for firms and certain individuals (eg directors). The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) can also revoke a firm’s authorization.

**What criminal penalties may apply?**

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment of up to five years.

There are further criminal penalties, eg for market abuse and for money laundering.

Tax

Tax issues

**Are stamp, registration, transfer or other similar taxes applicable?**

**Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?**

There are no stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan.

**Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

There are no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or...**
assignment of a debt security (eg a bond)?

There are no stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security.

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**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

The German tax authorities do not take priority over secured lenders or secured debt security holders on enforcement of security.

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**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Provided that the borrower is not a bank or financial services provider, generally no withholding tax will be levied. Withholding tax may, however, apply in the case of a loan that qualifies as profit participating. Generally, a loan qualifies as profit participating if either the claim for interest generally, or its amount, depends on the profitability of the borrower's business or specific parts thereof.

If so:

What is the rate of withholding?

Where applicable, the rate of withholding is 25%.

What are the key exemptions?

Most German double tax treaties allocate the taxing rights on interest to the contracting state in which the lender resides, which means that, in most cases, there is a full exemption from German withholding tax. Otherwise, most German double tax treaties limit Germany's taxing rights to a withholding tax rate of 10%.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

A lender which is not resident in Germany would only be subject to tax in Germany to the extent it receives German source income. German source income in this regard only includes interest paid on a:

- loan secured by real estate located in Germany or ships registered in a German register; and
- profit-participating loan.

Therefore, a lender which is not resident in Germany, would not be taxed on 'plain vanilla' interest income in Germany.
It should also be noted in this regard that most German double tax treaties exclude a German taxing right on interest payable or paid to a lender resident in the other contracting state (meaning that there is full exemption), and otherwise, most German double tax treaties limit Germany’s taxing right to 10% withholding tax.

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

Interest paid on a bond is generally not included in German source income. It is, however, included in German source income if:

- the bond is not held in a securities deposit account at the financial services provider paying out the interest; and
- the interest is paid on presentation of the respective interest coupon either in cash or by crediting such amount to an account of a person or entity that is not a bank or a financial services provider.

It should also be noted in this regard that most German double tax treaties exclude a German taxing right on interest paid or payable to a person resident in the other contracting state (meaning there is full exemption). Otherwise, most German double tax treaties limit Germany's taxing right to a withholding tax rate of 10%.

**Key contacts**

**Frank Schwem**
Partner
DLA Piper UK LLP
frank.schwem@dlapiper.com
T: +49 69 271 33 281
Ghana

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Under the Companies Act, 2019 (Act 992), companies may issue shares or debentures. Debentures may be in the form of individual loans or debenture stock representing units of debt issued to separate holders. Debentures are transferable without restrictions unless express provision is made to the contrary.

The business of arranging or underwriting the issuance of debt securities is carried out by licensed market operators such as issuing houses and broker-dealers.

Only public companies as defined in the Companies Act are permitted to make an invitation to the public to acquire shares or debentures. Such an invitation requires the issuance of a prospectus. It is usual, though not mandatory, for debt securities issued through invitations to the public to be listed on the Ghana Fixed Income Market which is part of the Ghana Stock Exchange.

More than 90% of listed debt securities are issued by government (i.e. central government or the central bank).

Government borrowing is subject to constitutional provisions and the provisions of the Public Finance Management Act, 2016 (Act 921). Pursuant to the Act, government debt securities are issued within the framework of a published medium-term debt management strategy and annual borrowing program.


External Issuance

Beyond the domestic markets, the government issues Eurobonds from time to time. In the last few years there has tended to be one Eurobond issue each year. Private companies may also issue debt securities externally.

What are common issuing methods and types of debt securities?

Issuing methods

Private: broker-dealers may underwrite debt securities for an issuer; issuing houses are in the business of arranging or underwriting the issue of securities.

Public: auctions, book-building; auctions are conducted by central bank – weekly for treasury bills and less frequently for other government securities.
Publicly issued debt may be listed on the stock exchange. There is also provision for listing of debt on the stock exchange without a public issue. A trust deed approved by the Securities Exchange Commission is required for listing non-government debt securities.

**Types**

Government securities include treasury bills, treasury notes, and bonds.

Short-term instruments include two-week, 91-day, 182-day, and 364-day bills. Two- to three-year notes are also issued periodically. There is currently an effort to shift towards three- to seven-year maturities. A small number of 10-year and 15-year bonds have been issued.

Listed corporate bonds have often been issued under medium-term note programs. Most listings have been by financial institutions or real estate companies. State-owned entities such as the Ghana Cocoa Board and Produce Buying Limited, and most recently a state-owned special purpose vehicle E.S.L.A. plc have issued in the corporate bond market.

Commercial paper is defined in the SEC Guidelines as having a fixed maturity ranging from 15 to 270 days.

Supra nationals and statutory bodies including local governments have been identified as potential issuers of listed debt securities but so far, they have issued none in the Ghanaian markets.

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**What are the differences between offering debt securities to institutional / professional or other investors?**

Only primary dealers are eligible to participate in Bank of Ghana auctions.

Trading on the GFIM is limited to authorized dealers. Investors must therefore buy and sell listed securities through brokers.

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**When is it necessary to prepare a prospectus?**

Every invitation to the public by a private (i.e. non-government) issuer or by a statutory body (e.g. a local government entity) requires a prospectus. There are circumstances where a statement in lieu of prospectus is acceptable and in the case of a restricted invitation, a short form prospectus may be sufficient.

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**What are the main exchanges available?**


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**Is there a private placement market?**

Yes, licensed broker-dealers, issuing houses etc. can enter into underwriting agreements and offer securities to their clients.

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**Are there any other notable risks or issues around issuing or investing in debt securities?**

Currency risk – domestic debt issues open to non-resident investors are denominated in GHS and therefore subject to exchange rate risk.
Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

The Securities Industry Act, 2016 (Act 929) sets out rules for the establishment of funds under the regulatory authority of the Securities and Exchange Commission.

These include requirements for a license to operate, appointment of trustee, manager and custodian, minimum capital and approval of prospectus by the Securities and Exchange Commission.

Hedge funds, private equity funds, venture capital funds, and collective investment schemes (mutual funds and unit trusts) all require a license from the Securities Exchange Commission as is also the case for fund managers, trustees, and custodians.

Specific provisions of the Securities Industry Act together with the Unit Trusts and Mutual Funds Regulations, 2001 (LI 1695) establish the regime governing the establishment and operation of mutual funds and units trusts.

Pension fund trustees require a license from the National Pensions Regulatory Authority established under the National Pensions Act, 2008 (Act 766). Trustees must be trust companies set up solely for that purpose; pension fund managers must be registered with the National Pensions Regulatory Authority.

What are common fund structures?

Collective investment schemes make up a substantial proportion of funds.

There has been a significant growth of pension funds since the enactment of the National Pensions Act, 2008 mandating that a part of pension contributions be paid into privately managed pension funds.

What are the differences between offering fund securities to professional / institutional or other investors?

The identified sources of funds for management include individuals, institutions, provident funds and welfare funds, collective investment schemes, endowments and foundations and pension funds.

Collective investment schemes designed to be offered to the general public including the retail investor are subject to elaborate and detailed regulation.

Pension funds are subject to an elaborate regulatory regime under the pension legislation.

Funds marketed to private high-net-worth clients or to professional or institutional investors are not subject to the elaborate regime for collective investment schemes under LI 1695.

Are there any other notable risks or issues around establishing and investing in funds?

The Securities and Exchange Commission has published a circular indicating permissible investments for fund managers.

Permissible capital markets instruments include local equity (listed and unlisted); foreign equity (listed); local bonds (listed and unlisted); foreign bonds (listed); preference shares; venture funds; mutual funds and unit trusts; notes (more than one year); others (as may be permitted by law).

Permitted money market instruments include fixed deposits issued by financial institutions regulated under the banking legislation; commercial paper issued pursuant to the Securities Exchange Commission’s Guidelines and treasury bills.
There are also provisions under the pensions legislation and guidelines issued by the National Pensions Regulatory Authority which prescribe the classes of assets permitted for pension fund investments as well as limits for different classes of assets and prohibitions on certain types of investments and transactions by pension funds.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

An advertisement for the marketing of a fund generally may only be made by a person licensed or authorized by the Securities and Exchange Commission. It must not be unclear, false or misleading and must comply with the Security and Exchange Commission Regulations, 2003 (LI 1728).

In relation to mutual funds and unit trusts, an invitation to the public to acquire shares or units is prohibited without a license from the Securities and Exchange Commission. The advertisement must be approved in writing by the trustee of the unit trust or board of directors of the mutual fund by a duly passed resolution and reproduce the approved scheme particulars or, where applicable, indicate where the scheme particulars may be obtained and the most recently published issue, sale, and repurchase or redemption price of an interest. An advertisement must also include a statement that an investor's right to redeem the investor's interests in certain circumstances may be suspended by the Securities and Exchange Commission. LI 1695 sets out additional details to be provided with regards to any investment plan advertised.

Are there any restrictions on managing a fund?

The Securities Industry Act, 2016 (Act 929) together with the Unit Trust and Mutual Funds Regulations, 2001 (LI 1695) prescribe the rules for the management of funds, and in particular, unit trusts and mutual funds.

Under Act 929 generally, a fund manager must:

- be licensed by the Securities and Exchange Commission;
- maintain a register of securities in respect of which it has an interests and notify the Securities and Exchange Commission where that register is kept;
- in any written communication in which it recommends any securities, disclose any interest it may have in any of the securities recommended;
- not give unsecured credit to anyone to purchase securities or in the knowledge that the unsecured credit will be used to purchase securities;
- operate in a manner that would ensure compliance with the Anti-Money Laundering Act, 2008 (Act 749) and Anti-Terrorism Act; and
- comply with the rules on trading in securities, including insider dealing and fraudulent practices in the sale and purchase of securities.

Additionally, for unit trusts and mutual funds, the manager must be a company incorporated in Ghana and have at least three directors. They must:

- have the minimum issued and paid up capital mandated by the Securities and Exchange Commission;
- not participate in prohibited transactions involving the lending or borrowing of money on behalf of the fund under Act 929;
- comply with the prescribed investment regime provided in Act 929, including the limitation on investments in securities in which the officers of the fund have an interest;
- submit half yearly and yearly investors' reports to holders of interests on the performance of their schemes; and
- obtain the prior approval of the Securities and Exchange Activities to engage in manager's own account transactions or investments in other collective investment schemes not licensed under Act 929.
Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

There are no generally applicable restrictions on derivatives. There is little in Ghanaian finance legislation specifically addressing derivatives contracts.

Authorization to enter into derivatives transactions is therefore entity-specific to be determined from the entity's corporate powers, and any mandatory regulatory provisions to which an entity may be subject.

With regard to the government, the Public Financial Management Act, 2016 (Act 921) provides that the government can engage in derivatives transactions as part of its debt management strategy.

The central bank uses derivative financial instruments such as forward currency contracts to hedge its foreign currency risks, interest rate risks and commodity price risks.

Statutory corporations may be authorized to enter into derivatives contracts to the extent that their enabling statutes give them such authority.

Local authorities appear to be restricted to “safe securities,” which is yet to be authoritatively interpreted but could be interpreted to exclude derivatives.

The central bank says that there are no restrictions as such on banks undertaking derivatives transactions but requires that they report these transactions.

There is currently no exchange that trades derivatives.

What are common types of derivatives?

Forward contracts, interest rate swaps, currency swaps and options.

Are there any other notable risks or issues around entering into derivatives contracts?

Legal risk

Legislative provisions on netting remain untested. There is no case law interpreting these provisions. There is as yet no ISDA legal opinion on netting or on collateral. There are elements in the corporate insolvency law regime which leave room for some uncertainty.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Requirement for license
Banks and specialized deposit-taking institutions and non-bank financial institutions require a license from the Bank of Ghana to carry on the business of lending.

**Banks and specialized deposit-taking institutions**

Certain restrictions apply to banks and specialized deposit-taking institutions regarding lending. They are prohibited from:

- granting an advance, loan or credit facility including a guarantee against the security of (i) their shares; (ii) shares of the financial holding company; or (iii) shares of a subsidiary of the financial holding company;
- taking financial exposure in respect of a person or a group of connected persons which constitutes in the aggregate, a liability amounting to more than 25% of their net own funds or a lower percentage that the Bank of Ghana may prescribe;
- taking an unsecured financial exposure in respect of a person or a group of connected persons in excess of 10% of their net own funds;
- granting or permitting to be outstanding, a financial exposure in respect of an affiliate or an insider which are preferential in any respect including creditworthiness, term, interest rate and value of the collateral;
- taking a financial exposure in respect of an affiliate if the aggregate of financial exposure to the affiliate exceeds 25% of the net own assets;
- taking a financial exposure in respect of related parties and their related interests if the aggregate of the financial exposure exceeds 20% of the net own funds;
- taking an unsecured financial exposure in excess of 10% of their net own funds;
- taking a financial exposure in respect of an insider and the related interest of the insider if the aggregate of the financial exposure exceeds 10% of its net own funds;
- taking an unsecured financial exposure in respect of an insider and the related interests of that insider in excess of 5% of their net own funds;
- lending on preferential terms to an employee unless the lending is part of a formally approved employment package or employment benefit plan;
- providing an unsecured advance on or credit facility to an employee the aggregate amount of which exceeds two years' total emoluments of the employee; and
- granting an aggregate amount of loans on preferential terms both secured or unsecured, in excess of 20% of their net own funds.

**Non-bank financial institutions**

Non-bank financial institutions are also prohibited from:

- granting an advance or credit or issuing financial guarantee or indemnity to or in respect of any person or group of persons which constitutes in the aggregate a liability to the institution amounting to more than the proportion of the net worth of the institution;
- granting an unsecured advance, credit, or issuing any guarantee or indemnity amounting in aggregate to more than the proportion of the net worth of the institution;
- granting to any of its officers or employees an unsecured advance or credit facility, the aggregate amount of which exceeds two years' salary of the officer or employee;
- assuming unsecured financial exposure in respect of (i) any of its directors or significant shareholders, (ii) a firm or company in which a director or a significant shareholder of that institution is interested as director, (iii) a controlling shareholder, partner, proprietor, employee or guarantor of that institution, (iv) a holding or subsidiary company of that institution in which a director is interested, or (v) a director's relative or a significant shareholder's relative, unless the prior written approval of the Bank of Ghana is obtained in respect of that unsecured exposure;
- assuming a financial exposure in respect of a director or a significant shareholder or other related party in excess of (i) 15% of the institution's net own funds where the financial exposure is on a secured basis, or (ii) 10% of the institution's net own funds where the financial exposure is on an unsecured basis; and
• writing off or waiving fully or partially, the financial exposure of the institution to a director, a significant shareholder and other related party without the approval of the institution's board and the approval in writing of the Bank of Ghana.

Protection against discrimination

The Borrowers and Lenders Act, 2008 (Act 773) prohibits a lender from discriminating against a person on the grounds of race, gender, ethnicity, political affiliation or religion in: (a) assessing the ability of the person to meet the obligations of a proposed credit agreement; (b) deciding whether to refuse an application to enter into a credit agreement, or to offer or enter into a credit agreement; (c) determining an aspect of the cost of a credit agreement to the borrower; (d) proposing or agreeing on the terms and conditions of a credit agreement; (e) assessing or requiring compliance by the person with the terms of a credit agreement; (f) exercising any right of the lender under a credit agreement, Act 773 or any legislation relating to credit; or (g) determining whether to continue, enforce, seek judgment as regard a credit agreement or terminate a credit agreement.

Protection of borrower credit rights

Where a borrower exercises a right under the Borrowers and Lenders Act, 2008 (Act 773) the lender is prohibited from responding by: (a) penalizing the borrower; (b) altering, or proposing to alter the terms or conditions of a credit agreement with the borrower to the detriment of the borrower; or (c) taking an action to accelerate, enforce, suspend or terminate a credit agreement with the borrower. A dissatisfied borrower may have recourse to the complaint procedures and redress mechanisms provided under the central bank’s Consumer Recourse Mechanism Guidelines for Financial Service Providers, 2017.

Borrowing

The following restrictions apply to the entities indicated below:

BANKS, SPECIALIZED DEPOSIT-TAKING INSTITUTION OR FINANCIAL HOLDING COMPANY

A bank, specialized deposit-taking institution or financial holding company which has a capital adequacy ratio of less than the ratio prescribed by the Bank of Ghana is prohibited from receiving a loan from another bank, specialized deposit-taking institution or financial holding company without written approval from the Bank of Ghana.

STATUTORY CORPORATIONS AND STATE-OWNED ENTERPRISES

The written approval of the Minister responsible for Finance is required for a public corporation or state-owned enterprise to borrow from a foreign market or to borrow an amount above the limit determined by the minister.

LOCAL GOVERNMENT AUTHORITIES

A local government authority may borrow funds only from within Ghana and up to the limit determined by the minister responsible for finance in consultation with the minister responsible for local government. The prior written approval of the minister responsible for finance is required for the borrowing above the determined limit.

GOVERNMENT OF GHANA

The terms and conditions of all government borrowings require parliamentary approval. The minister for finance may subject to parliamentary approval, enter into and execute an agreement on behalf of the government in relation to matters of a financial nature.

Government borrowing from banks and financial institutions under a loan agreement must be based on the annual borrowing plan.

What are common lending structures?

Various lending structures are used depending on the financing needs of the borrower and requirements of the parties. Loans may be provided by a single lender providing the entire facility or multiple lenders each providing parts of the total facility.

Duration of loan
A loan may be structured as a term loan, revolving loan, overdraft or bridge loan.

Security

Loans may be secured, unsecured or guaranteed.

Loan repayment

A loan may also be structured to be repayable in installments of both principal and interest over the life of the loan, by paying interest-only during the term of the loan with only the outstanding principal due at the end or repayable in full at maturity.

What are the differences between lending to institutional / professional or other borrowers?

There are specific rules such as the restrictions indicated above that apply to banks, specialized deposit-taking institutions, statutory corporations and local government authorities, but do not apply to individual borrowers.

Do the laws recognize the principles of agency and trusts?

Ghanaian law recognizes the principles of agency and trusts.

Are there any other notable risks or issues around lending?

Default on interest

A Ghana Court may refuse to order the recovery of default interest on the ground that such interest amounts to a penalty.

Insolvency issues

On the commencement of official liquidation, remuneration up to a prescribed limit owed to employees in respect of the whole or a part of the four months preceding the commencement of the winding-up and rates, taxes, or similar payments owed to the state or a local authority have priority over payments to floating charge creditors and general unsecured creditors of the company.

Are there any other notable risks or issues around borrowing?

Credit reporting

Where a borrower's loan is 90 days past the due dates for repayment, the details are required to be disclosed by the creditor (financial institution) to a licensed credit bureau.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?
There are no statutory restrictions on the giving or taking of security. There may, however, be contractual restrictions such as negative pledges or requirements to obtain consent from counterparties to certain agreements.

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What are common types of guarantees and security?

Guarantees

The types of guarantees commonly used are corporate guarantees and personal guarantees.

Security

Security arrangements can take various forms depending on the agreement of the parties. In Ghana, parties usually use fixed or floating charges, pledges or mortgages.

Where the borrower is a company, the ideal form of security is a full debenture containing fixed and floating charges over all assets of the company.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Registration of security

A borrower or a person interested in a charge is required to register it with the Collateral Registry within 28 days after the date of its creation. An unregistered charge "is of no effect as security for a borrower's obligations for repayment of the money secured."

Charges created by a company over its property must additionally be registered with the Companies Registrar within 45 days of its creation, failing which the charge is void as security over the property. Pledges of goods, documents of title and negotiable instruments are excluded from the requirement for registration.

Interests in land are subject to registration under the Land Title Registration Act, 1986 (PNDCL 152) and the Land Registry Act, 1962 (Act 122). An instrument conveying an interest in land is ineffective until it has been registered.

Ascertainment of ownership

Lenders face the risk of creating an ineffective security where they fail to ascertain or verify the ownership of the assets, especially landed property, before taking security over them.

Insolvency issues

If a company is wound up under the provisions of the Bodies Corporate (Official Liquidations) Act, 1963 (Act 180), the following provisions apply:

FLOATING CHARGES

A floating charge created during the 12 months before the winding up of the company may – except to the extent of any cash paid in consideration for it – be rendered invalid on the commencement of the winding-up of the company, unless it is established that the company was solvent immediately after the creation of the charge.

Floating charges may also be affected by the operation of the preference provisions of the insolvency laws as outlined below.

The liquidator may call for a restoration of money paid or transfer of property or its value if:

• the underlying transaction is entered into by the company before the winding up of the company commences with the "dominant intent" that the particular creditor should benefit at the expense of others; or
• a payment was received during the relevant period (beginning 21 days before the presentation of the petition on which a winding-up order is made) other than payments made in respect of secured debts and debts incurred during the relevant period.

The liquidator is also entitled to call upon a person to restore any excess benefit accrued to him from the disposition of property otherwise than for full value or in settlement of any due debt either during the two years ending with the making of a winding-up order, or more than two years, but less than ten years before the making of the order and at a time when the company was insolvent.

ASSIGNMENTS

In relation to two or more assignments in respect of the same debt, later assignees take priority over earlier assignees if the debtor or other person against whom the right is enforceable did not have notice of the earlier assignment at the time of the later assignment.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Banking and Securities

Bank of Ghana Act, 2002 (Act 612)
Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930)
Non-Bank Financial Institutions Act, 2008 (Act 774)
Bank of Ghana notices, directives and circulars
Securities Industry Act, 2016 (Act 929)
Securities and Exchange Commission Guidelines, Directives, Codes and Circulars
Ghana Stock Exchange Listing Rules 2006
Ghana Stock Exchange Listing Regulations, 1990 (LI 1509)
Ghana Stock Exchange Membership Regulations, 1990 (LI1510)

Bodies Corporate

Companies Act, 2019 (Act 992)\(^1\)
Incorporated Private Partnerships Act, 1962 (Act 152)
Bodies Corporate Official Liquidations Act, 1963 (Act 180)

Mortgages

Mortgages Act, 1972 (NRCD 96)
Home Mortgage Finance Act, 2008 (Act 770)

Insurance and Pensions

Insurance Act, 2006 (Act 724)

Other relevant legislation

Anti-Money Laundering Act, 2008 (Act 749)
Anti-Terrorism Act, 2008 (Act 762)
Bills of Exchange Act, 1961 (Act 55)

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1. \(^1\) Companies Act, 2019 (Act 992)
Borrowers and Lenders Act, 2008 (Act 773)
Central Securities Depository Act, 2007 (Act 733)
Contracts Act, 1960 (Act 25)
Credit Reporting Act, 2007 (Act 726)
Data Protection Act, 2012 (Act 843)
Electronic Transactions Act, 2008 (Act 772)
Finance Lease Act, 1993 (PNDCL 331)
Foreign Exchange Act, 2006, (Act 723)
Ghana Deposit Protection Act, 2016 (Act 931)
Ghana Investment Promotion Centre Act, 2013 (Act 865)
Income Tax Act, 2015 (Act 896)
Payment Systems and Services Act, 2019 (Act 987)
Public Financial Management Act, 2016 (Act 921)
Stamp Duty Act, 2005 (Act 689)
Venture Capital Trust Fund Act, 2004 (Act 680)

Reference to an Act includes its amendments and regulations.

1The Companies Act, 2019 (Act 992) came into effect on 2 August 2019.

Regulatory authorization

Who are the regulators?

The central bank (Bank of Ghana) is the supervisory and regulatory authority for all banks, specialized deposit-taking institutions and non-bank financial institutions.

The securities industry is regulated by the Securities Exchange Commission under the Securities Industry Act, 2016 (Act 929).

The Ghana Stock Exchange is recognized by the Securities and Exchange Commission as a self-regulatory organization authorized to prescribe rules for its members as market participants.

The National Insurance Commission supervises and regulates institutions within the insurance industry under the Insurance Act, 2006 (Act 724).

The National Pensions Regulatory Authority establishes standards, rules and guidelines for the management of pension funds, including guidelines for pension fund investments. It approves, regulates and monitors trustees, pension fund managers, custodians and other institutions that deal with pensions and supervises the administration by trustees of registered schemes.

What are the authorization requirements and process?

Depending on the type of activity to be conducted, an application must be made to the Bank of Ghana, Securities and Exchange Commission, National Pensions Regulatory Authority or National Insurance Commission for a license.

Bank of Ghana

The Bank of Ghana is responsible for:

- issuing licenses to banks and specialized deposit-taking institutions;
- approving the establishment of representative offices by foreign banks; and
- registration of financial holding companies.
The application for a license to carry on a deposit-taking business must be in writing accompanied by the required information and processing fee. The application must show that the applicant meets the threshold conditions for eligibility.

The Bank of Ghana must inform the applicant of its decision within six months of the submission of the application. If it requires further information or investigation, it must inform the applicant and make its decision within a reasonable additional time period.

**Securities and Exchange Commission**

An application must be made in a prescribed form. There is a prescribed fee payable which ranges from GHS400 to GHS1,000 depending on the type of license applied for, as well as an annual renewal fee ranging from GHS200 to GHS500. There is a minimum capital requirement to be met for a license may be granted.

**National Insurance Commission**

Only a limited liability company may apply for a license. The application for the license must be made in the prescribed form accompanied by the required information and fee.

**National Pensions Regulatory Authority**

An application may be made in the prescribed form accompanied by the required information and fee.

**Trustees**

Both individuals and trust companies may apply for a license to serve as trustees for occupational pension schemes, provident fund schemes, personal pension schemes and other privately managed pension schemes. They must meet the eligibility requirements set out in the National Pensions Act, 2008 (Act 766).

**Pension fund managers**

Only a body corporate licensed by the Security and Exchange Commission as an investment advisor may apply to be registered as a pension fund manager.

**Pension fund custodians**

Only a bank, an insurance company or a non-bank financial institution or wholly owned subsidiary of any of these institutions licensed by the Securities and Exchange Commission as a custodian may apply to be registered as a pension fund custodian.

*Last modified 15 Jan 2020 | Authored by Reindorf Chambers*

**What are the main ongoing compliance requirements?**

**Bank of Ghana**

Banks and specialized deposit-taking institutions are required to maintain the prescribed minimum unimpaired paid up capital and minimum capital adequacy ratios, become members of the Ghana Deposit Protection Scheme, pay an annual license fee and comply with any conditions imposed by the Bank of Ghana or statutory provision. Failure to meet these requirements may result in the revocation of the license.

**Securities and Exchange Commission**

The Securities Exchange Commission must be notified by an institution to which it has granted a license of any change of particulars from those submitted in the application form within 14 days of the change. Other compliance requirements include notifying the Securities and Exchange Commission of the appointment, removal and resignation of auditors within 30 days of the occurrence (except for banks and insurance companies), maintaining the prescribed minimum liquid funds and appointing a designated compliance officer. The failure to comply with these requirements may result in a penalty of GHS500 for each infringement and the suspension, revocation or restriction of a license.
National Insurance Commission

A company must maintain the prescribed solvency margin and minimum capital (or higher amount where one is imposed by the National Insurance Commission), prescribed level of reserves and also deposit 10% of the minimum capital with the Bank of Ghana when required to do so.

The insurance company must notify the National Insurance Commission within 14 days of the termination of the appointment of a director, auditor or senior member of staff. The prior written approval of the National Insurance Commission is required for:

- the appointment of a director or a principal officer.

National Pensions Regulatory Authority

A trustee, pension fund manager or custodian must report fraud, forgery, theft or other acts of dishonesty that occur in its establishment and a staff member whose appointment is terminated on any of these grounds to the Board of the National Pensions Regulatory Authority. A trustee, pension fund manager or custodian is prohibited from employing a person whose name is on the list maintained by the National Pensions Regulatory Authority of employees dismissed on those grounds without its prior approval.

Failure to report any of the above-mentioned incidents is an offense punishable by a fine of GHS24,000 or a term of imprisonment of not more than two years or, where applicable, both.

A trustee, pension fund manager or custodian who employs a person named in the above dismissed employees list is liable to a penalty of an amount of not less than GHS3,000 or, in the case of persistent contravention, revocation of license or registration.

What are the penalties for failure to be authorized?

Bank of Ghana

A person who undertakes a regulated activity without a license commits an offense and upon summary conviction may be liable in the case of a body corporate, to a fine ranging from GHS18,000 to GHS60,000 or in the case of an individual, either the above fine and/or a term of imprisonment ranging between two to four years.

Securities and Exchange Commission

A person who undertakes a regulated activity within the securities industry without a license is liable to pay a penalty of GHS48,000.

National Insurance Commission

A person who undertakes an insurance activity without a license commits an offense and is liable on summary conviction to a fine not exceeding:

- in the case of a body corporate, to a fine of GHS30,000; or
- in the case of an individual, either a fine of GHS30,000 or a term of imprisonment of five years or to both.

A director, partner or officer of a corporate body or partnership convicted of undertaking an insurance activity without a license shall be considered to have committed an offense and is liable to the fine and/or term of imprisonment stated above.

National Pensions Regulatory Authority

Anyone who acts as a trustee without a license commits an offense and is liable on summary conviction to a fine of GHS24,000 in the case of a body corporate or, to a term of imprisonment not exceeding two years or to both in the case of an individual.

A body corporate which acts as a pension fund manager or custodian without registration is liable on summary conviction to a fine of not more than GHS12,000.
Regulated activities

What finance and investment activities require authorization?

A person shall not carry on a deposit-taking business in Ghana without a license issued by the Bank of Ghana. In addition to taking money on deposit, deposit-taking businesses are permitted to engage in financial activities such as lending, financial leasing, investment in financial securities, participation in securities issues and provision of services related to those issues, electronic banking, money transmission services and issuing and administering means of payment including credit cards, travelers checks, bankers’ drafts and electronic money.

A person cannot establish or maintain a securities exchange, unit trust or mutual fund, or carry on business as a market maker or market operator in the securities market without a license issued by the Securities and Exchange Commission. Market operators include broker-dealers, investment advisors, trustees, custodians, fund managers or underwriters.

Banks and financial institutions which do business in the capital market other than as custodian, trustee, primary dealer, nominee, registrar, issuing house and underwriter, must incorporate a subsidiary company and obtain a license for that subsidiary.

A person cannot act as a representative of a market maker or market operator without a license.

Are there any possible exemptions?

A representative of a market maker or operator who does not deal directly with clients may be exempted from holding a representative's license.

A foreign bank or company may be exempt from registration as a financial holding company where the Bank of Ghana is satisfied that it is subject to satisfactory supervision and regulation in its home jurisdiction.

Do any exchange controls or other restrictions on payments apply?

There are no foreign exchange controls in relation to the remittance of the principal amount invested, or any capital gains, dividends, interest payment or any related earnings.

However, foreign currency payments to and from Ghana between a Ghana resident and non-resident, or non-residents, must be made through a bank. Transfers of foreign currency to or from Ghana must also be made through a licensed person.

There are two types of accounts involving non-Ghanaian currency that Ghana residents may operate, to which different terms and conditions apply with regard to the source of funds and the making of external transfers. Only one of the two categories of account is available to non-residents.

A licensed specialized deposit-taking institution cannot trade in foreign exchange or offer services denominated in a foreign currency.

The Bank of Ghana has powers to restrict the importation and exportation of foreign currency and securities denominated in such currency.

A declaration must be made at the point of entry or exit into the country where foreign currency beyond a prescribed amount is being conveyed.

A bank or specialized deposit-taking institution must report any currency transaction greater than the prescribed threshold amount to the Financial Intelligence Centre.

What are the rules around financial promotions?
An invitation to the public to buy or sell shares or debentures of a company or to deposit money with any company for a fixed period or payable at call can only be made in relation to a public company.

No advertisement in connection with any activity or service which must be licensed or authorized by the Securities and Exchange Commission may be made by a person other than a licensed or authorized person.

An advertisement by a licensed or authorized person in connection with any activity or service which must be licensed or authorized by the Securities and Exchange Commission must not be unclear, false or misleading in any material particular.

The Securities and Exchange Commission may direct a person who publishes an advertisement in contravention of these provisions to cease the publication or modify the advertisement.

A false or misleading statement in a material particular that is likely to induce the sale or purchase of securities by any other person, whether or not made knowingly, recklessly or dishonestly, is an offense for which, upon summary conviction, a person may be liable for the payment of a fine ranging from GHS12,000 to GHS30,000, or a term of imprisonment of four to five years and or, where applicable, both.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

The most common types are companies limited by shares which may be private or public. Private companies can have up to 50 shareholders or members while public companies have unlimited shareholders or members. Incorporated partnerships may also be used to provide some services.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes. A company can conduct lending or investment business through a branch, or in the case of a company incorporated outside Ghana (external company), through an established place of business registered under the Companies Act, 2019 (Act 992).

An external company is subject to the licensing requirements of the banking and securities industry laws and has tax liability under Ghana law.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

The fintech space has been described as vibrant and burgeoning. In 2018, the central bank counted 71 fintech operators providing services to the banking sector. Payment services and mobile money are the most widely used technology products. Banks are increasingly collaborating with telecommunications companies (Telcos) to offer products and services to holders of mobile money accounts. The Ghana Interbank Payment and Settlement System operated by a subsidiary company of the central bank has enabled inter-operability across the financial institutions and the Telcos. A number of licensed financial institutions have deployed various online technologies to offer savings and loan products. Fintech enterprises have been active in online remittances, lending and insurance. Some have used
peer-to-peer funding platforms and engaged in marketplace lending. A small number are beginning to offer services based on artificial intelligence and robo advisory systems and some are developing the use of blockchain technology. A few have been involved in initial coin offerings. There are several cryptocurrency trading platforms operating. Data analysis and cloud computing capabilities are also being developed by some fintech companies.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

Other than as specified in this section, there are as yet no fintech-specific laws or regulations. Where fintech businesses engage in regulated activity such as deposit-taking, lending, insurance or investment, they are subject to the rules generally applicable to those activities.

The Payment Systems and Services Act, 2019 (Act 987) which entered into force on 14 May 2019 establishes a regime of licensing and regulation by the central bank of payment service providers, operators of payment systems, and electronic money issuers. Existing operators have been given nine months to comply with the new regime. It is not yet clear if all electronic payment platforms will be regulated as payment systems under the Act.

A payment service provider or electronic money issuer must have at least 30% Ghanaian ownership. The Bank of Ghana may prescribe minimum capital requirements.

Regulations under the Payment Systems and Services Act are to be issued by the Minister of Finance on the advice of the central bank.

Application of data protection

A registration certificate from the Data Protection Commission is required in an application for a license by a payment service provider or electronic money issuer. The data protection principles enacted in the data protection legislation apply to entities providing these services.

Consumer laws

Consumer protection principles, including transparency, disclosure of sufficient information, fair treatment and client access to redress are laid down in Act 987. The central bank has the authority to make final determination of complaints by clients against payment services providers and electronic money issuers.

Money laundering regulations

Fintech businesses are likely to belong to the extensive list of entities identified as “accountable institutions” under the anti-money laundering legislation e.g. as businesses which provide financial services that involve the remittance or exchange of funds; they are therefore subject to record-keeping, due diligence, client identification and verification, reporting and disclosure obligations and liable to sanctions prescribed for breach of these obligations.

Cryptocurrency

The Securities and Exchange Commission and the Bank of Ghana have both issued directives on cryptocurrency indicating that they do not license or regulate cryptocurrency. Act 987 does not appear to have changed that position.

What type of funding arrangements and incentives are available to FinTech businesses?

Startups in fintech face the constraint that there is little available by way of venture capital and debt for startups in general. Banks and investors typically prefer growth companies with a three- to five-year track record. However, a good business case with credible promoters with a track record can attract funding.
Established companies entering the fintech space such as the Telcos have access to capital markets and senior debt financing.

Tax breaks have recently been introduced for young entrepreneurs. The income of a person who is 35 years old or under from an information and communications technology business is exempt from tax for the first five years of the business and a concessional tax rate may be applicable for the next five years.

The capital allowances regime is designed to enable investors recoup their investment expenditure.

Portfolio sales

Loan transfers and portfolio sales

*What are common ways of buying and selling loans?*

The most common ways of selling loans in Ghana are by way of:

- assignment; and
- novation.

*What are the main considerations when transferring a loan and related security?*

The main considerations for transferring a loan and related security are whether:

- the underlying contract allows for such transfer;
- the consent of the borrower or any other party is required for such transfer;
- there are limitations on the financial institution(s) to whom the loan and related security may be transferred;
- there are any stamp duty implications;
- the transfer will prejudice the borrower; and
- there are any formalities that need to be adhered to for the transfer of a loan and related security.

Projects

Financing / investing in energy / infrastructure

*To what extent are energy and infrastructure assets publicly or privately owned?*

Energy

Energy assets are publicly or privately owned or by way of joint venture.

Electricity

There are currently three hydro-electric dams in Ghana, all of which are state-owned.
The Volta River Authority (VRA), a statutory authority responsible for generating electricity, owns a number of thermal plants located in Aboadze near Takoradi, and within the Tema enclave, with a combined generation capacity of 1,292MW. The 340MW Takoradi Thermal 2 (T2) Power Plant is a joint venture between VRA and a private company from Abu Dhabi. There are also other independent power producers who are contributing to the energy generation capacity.

VRA owns a 2.5MW Solar Power Plant located in Navrongo, in the Upper East Region. Two other solar plants located at Gomoa Onyandze near Winneba in the Central Region were developed by private entities.

Power Distribution Services Ghana Limited, which comprises Ghanaian investors (51%) and foreign technical partners (49%), recently took over operations of the Electricity Company of Ghana (ECG). It is currently the electricity service provider in all of ECG's operational areas in the southern distribution zone of Ghana. The Northern Electricity Distribution Company (NEDCo) is responsible for distribution of electricity in the northern sector of the country. Ghana Grid Company (GRIDCo), a wholly owned government entity which has responsibility for the transmission functions of the electricity sector owns a majority of the transmission facilities.

Oil and Gas

There are three major oil fields in Ghana: Jubilee, SGN and TEN. They are operated by two international oil companies on behalf of the joint venture partners including the Ghana National Petroleum Corporation (GNPC) a statutory corporation responsible for undertaking the exploration, development, production and disposal of petroleum.

Bulk Distribution Companies, Oil Trading Companies and Oil Marketing Companies licensed by the National Petroleum Authority to import, export, distribute and market crude and petroleum products, are largely privately owned.

Ghana has a gas processing plant located at Atuabo in the Western Region operated by the Ghana National Gas Company which is mandated to build, own and operate infrastructure required for the gathering, processing, transporting and marketing of natural gas resources in the country.

Telecommunications infrastructure

The National Communications Authority (NCA) is responsible for regulating the provision of communications services in Ghana. Telecommunications infrastructure is largely privately owned.

There are four mobile network operators in Ghana, three of which are wholly privately owned. They are AirtelTigo, Glo, MTN and Vodafone, in which the government of Ghana has about 30% shareholding. Vodafone and AirtelTigo also provide fixed line services to the public.

The mobile telecommunications sector has about 5,000 communication towers, the majority of which are owned by three privately owned tower companies.

Transport infrastructure

ROAD

Road transport is the primary land transport system in Ghana. Ownership of the road network is held by the government. The Ghana Highway Authority is responsible for the administration, control, development and maintenance of trunk roads and related facilities.

RAIL

Rail infrastructure in Ghana is currently largely government-owned. The Ghana Railway Company Limited operates the railways and is responsible for managing the national rail system.

Government has been seeking private sector participation in the development and rehabilitation of railway infrastructure. The Ministry of Railways Development has for example recently entered into a concession agreement with the Ghana European Railway Consortium (GERC) (which consists of 16 investment companies from Ghana, Germany, Austria, France and Italy) for the construction of the Eastern Railway line.

AVIATION

Cargo and passenger aviation is privately owned. The Ghana Civil Aviation Authority is responsible for the regulation of the aviation sector.
The only international airport, Kotoka International Airport, is owned by the government and managed by the Ghana Airports Company Limited. There are domestic airports in Kumasi, Sunyani, Tamale and Takoradi. An airport is being constructed in Ho and the government plans to convert the Kumasi airport into an international airport.

Two private passenger airlines currently operate domestic flights. Three others have suspended operations.

PORTS

The government dominates infrastructure ownership in this sector. The two main ports are located in Tema and Takoradi. The Ghana Ports and Habours Authority is the statutory body responsible for planning, building, developing, managing, maintaining and operating ports in Ghana. The government has indicated that there are plans to develop a port in Keta and an inland port in Boankra near Kumasi to facilitate trade with neighboring landlocked countries.

Other infrastructure

EDUCATION INFRASTRUCTURE

Ownership of education infrastructure is a combination of public and private ownership. A majority of these are public schools. It is reported in the Ghana Education Service's Education Management Information System data that in the 2017-2018 academic year, there were 21,730 public basic schools and 10,056 private basic schools in Ghana. Regarding Senior High Schools, 630 were publicly owned and 286 of them were privately owned.

HOSPITAL INFRASTRUCTURE

Health facilities in Ghana are both publicly and privately owned.

The Ghana Health Service in its 2017 facts and figures report indicates that in 2016 about 78.7% of hospital beds in the country were publicly owned and 16.9% privately owned.

Are there special rules for investing in energy and infrastructure?

Minimum equity capital contribution

Generally, under the Ghana Investment Promotion Centre Act, in a joint venture between a Ghanaian and a foreign shareholder, the foreign shareholder is required to make a minimum equity capital contribution of USD200,000. A wholly foreign owned venture requires a minimum equity capital contribution of USD500,000.

Energy

ELECTRICITY OWNERSHIP

The Energy Commission (Local Content and Local Participation) (Electricity Supply Industry) Regulations, 2017 (L.I. 2354) prescribes local content and local participation levels applicable to persons engaged or intending to engage in the electricity supply industry. LI 2354 is aimed at achieving a long-term goal of minimum local content of 60% and local participation of 51% in the electricity supply industry.

LICENSING

A public utility requires a license from the Energy Commission for the transmission, wholesale supply, distribution or sale of electricity.

Oil and Gas

OWNERSHIP

The right to develop oil and natural gas reserves is granted through a petroleum agreement between the Minister responsible for Petroleum acting on behalf of Ghana, the Ghana National Petroleum Corporation (GNPC) and the investor who should be a body corporate. The GNPC is entitled to a 15% initial participating carried interest in all petroleum exploration and development operations and
may acquire an additional participating interest which may be for a specified period and shall be a paying interest in respect of costs incurred in the conduct of petroleum activities other than exploration costs.

To qualify to enter into a petroleum agreement or be granted a petroleum license, there must be at least 5% equity participation of an indigenous Ghanaian company other than the GNPC. Again, a non-indigenous company which intends to provide goods or services to a contractor, a subcontractor, or a licensee in Ghana is required to establish a joint venture company with an indigenous Ghanaian company and afford it an equity participation of at least 10%.

Prior written consent of the Minister for Energy is required for the assignment of interests in a petroleum agreement.

In relation to downstream petroleum activities, a license holder is required to have at least 50% Ghanaian ownership.

**Licensing**

A permit is required from the Petroleum Commission to install and operate any facility for the purpose of transporting, treating and storing petroleum.

In the midstream sector, the prior written approval of the Energy Commission must be obtained in order to commence the construction, installation, operation or modification of a pipeline.

A license is required from the Energy Commission for the transmission, wholesale supply or distribution of natural gas.

A license is required from the National Petroleum Authority to engage in a business or commercial activity in the downstream industry including importation, exportation, re-exportation and shipment of crude oil, gasoline, diesel, liquefied petroleum gas, kerosene and other designated petroleum products.

**Telecommunications**

A person who operates a public electronic communications service or network or provides a voice telephony service requires a license from the NCA.

A person who has a significant interest in a network operator, service provider or the holder of a frequency authorization is prohibited from selling, transferring, charging or otherwise disposing of that interest or any part of that interest, unless notice is given to the NCA 30 days before the proposed transaction.

Holders of frequency authorizations, network operators or service providers are required to give prior notice to the NCA of the (a) sale, transfer, charge or other disposition of a significant interest, (b) issuance or allotment of any shares or any other reorganization of their share capital that would result in: (i) a person acquiring a significant interest or (ii) a person who already owns or holds a significant interest, increasing or decreasing the size of that person’s interest.

A person who acquires a significant interest in a network operator or service provider is required to notify the NCA within 14 days of the acquisition except where the sale is as a result of an internal reorganization of a network operator or service provider.

The prior written approval of the NCA is required for the assignment of the license of a network operator or network provider or a frequency authorization.

**What is the applicable procurement process?**

Procurement of works and services with public funds must be in accordance with the Public Procurement Act, 2003 (Act 663) as amended which sets various thresholds, procurement procedures and approvals required to embark on such projects. Procurement entities are required to have tender committees to which they must submit not later than one month prior to the end of each financial year, their procurement plan for the following year.

There are procedures prescribed under the Act for the procurement of goods, services, and works and the engagement of consultants. Generally, competitive selection procedures are preferred, with single source procurement as a possible exception.
What are the most common forms of funding / investing in energy and infrastructure?

Funding

Common forms of funding in energy and infrastructure include:

- direct government budgetary expenditure;
- government borrowing from development finance institutions;
- government guarantees and commitments to concessionaires; and
- debt and equity raised on a project-finance basis.

There is a growing interest in pursuing infrastructure development through public-private partnership arrangements.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

In addition to the regulatory investigations specified in this section, there are a number of provisions in the Companies Act, Anti-Money-laundering Act and Data Protection Act which vest authorities named in the legislation with powers to investigate breaches of those laws together with accompanying sanctions which may affect persons regulated in the financial sector.

Bank of Ghana

The Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930) authorizes the Bank of Ghana to carry out an investigation where there is sufficient reason to believe that a person is taking deposits or carrying out a deposit taking business without a license.

In addition to its general powers of routine inspection, the Bank of Ghana may also carry out unannounced examinations of specific activities or matters relating to the affairs of a bank, specialized deposit-taking institution, financial holding company, electronic money issuer or payment service provider.

Securities and Exchange Commission

The Securities Industry Act, 2016 (Act 929) authorizes the Securities and Exchange Commission to carry out an investigation where there is sufficient reason to suspect that a person has committed an offense under that Act or the Companies Act, or has been guilty of fraud or dishonesty in relation to securities dealings and the issue of securities. It may also carry out an investigation in circumstances where a person is assisting other domestic and foreign regulatory authorities in an investigation.

National Insurance Commission

Where the National Insurance Commission is of the opinion that it may take enforcement action against an insurer on any of the grounds set out in the Insurance Act, 2006 (Act 724), it may appoint a competent person to carry out an investigation into the nature, conduct or state of the insurer's business or any particular aspect of it, or the ownership and control of the insurer.

The National Insurance Commission may also at any time authorize an actuary to investigate the financial condition of an insurer.

National Pensions Regulatory Authority

The Board of the National Pensions Regulatory Authority may examine the activities of a trustee, pension fund manager or custodian at least once in a year to determine whether or not the provisions of the National Pensions Act or any regulations made under it are being complied with. It may also order a special examination of the books and affairs of a trustee, pension fund manager or custodian where it
What regulatory penalties may apply?

Bank of Ghana

After the Bank of Ghana provides the entity investigated with its investigation report, it may require the entity to submit an explanation for the findings in the report. An entity which fails to submit an explanation upon request is liable to an administrative penalty of not more than GHS12,000.

After the Bank of Ghana receives an explanation for its findings from the entity investigated, it may direct the entity to take remedial action within a stated period of time. An entity which fails to comply with the directives given by the Bank of Ghana is liable to an administrative penalty of not more than GHS24,000.

Other regulatory penalties which may be imposed by the Bank of Ghana after an examination into the operations of an entity include the appointment of an advisor or official administrator and remedial measures set out in sections 102 and 103 of the Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930) against both the entity and its directors and key management personnel such as an order to the bank or specialized deposit-taking institution to cease the violation or unsafe practice.

Securities and Exchange Commission

For a breach of the Securities Industry Act, 2016 (Act 929) which does not constitute a criminal offense, the Securities and Exchange Commission may impose an administrative fine of an amount specified in relation to the particular breach, or if no amount is specified, GHS36,000. For example, a person who carries out the business of a market operator without a license may be fined GHS54,000. It may also nullify the purchase of shares following a takeover, consolidation or merger involving a public company if it determines that the Code has been violated.

National Insurance Commission

The National Insurance Commission may suspend or revoke an insurance license upon notice to the license holder stating the reasons for the suspension or revocation. It may also give directives to the license holder, including a directive to cease to engage in any class of insurance business or not to enter into any new contracts for any class of insurance business.

National Pensions Regulatory Authority

Regulatory penalties which may apply include the removal from office of a director or officer of a trustee, pension fund manager or custodian who fails to submit reports of any fraud, forgery, theft or other acts of dishonesty which occurs in the establishment. Other penalties are the payment of an amount not less than GHS3,000 for employing a person whose name is on the list kept by the Board of the National Pensions Regulatory Authority of persons dismissed for fraud or other dishonesty and, for persistent offenders, revocation of license.

What criminal penalties may apply?

Bank of Ghana

Breaches of Act 930 as well as any conditions imposed by the Bank of Ghana on any of the entities it regulates may result in criminal prosecution.

A person convicted of an offense under Act 930 may be liable to a fine of the amount or a term of imprisonment for the number of years provided for that offense.

Securities and Exchange Commission
Breaches of the Securities Industry Act, 2016 (Act 929) as well as any conditions imposed by the Securities and Exchange Commission on any of the entities it regulates may result in criminal prosecution.

For a breach of Act 929 which constitutes a criminal offense, a person may be liable on summary conviction to a fine for an amount or to a term of imprisonment specified in relation to the particular breach, or to both. If no penalty is specified, a fine of between GHS1,800 and GHS6,000 or term of imprisonment of between one year and three years or both may be imposed. For example, a person who fraudulently induces another person to deal in securities is liable on summary conviction to a fine between GHS12,000 and GHS30,000 or to a term of imprisonment of between four to five years or to both.

National Insurance Commission

The First Schedule of the Insurance Act, 2006 (Act 724) sets out a list of offenses created by the Insurance Act, 2006 (Act 724) and applicable penalties. A person summarily convicted of an offense under the Insurance Act or who contravenes any of its provisions is liable to a fine (including where applicable, a daily default fine for each day that the default continues) or, in the case of an individual, a fine or term of imprisonment or to both. If a penalty is not provided for an offense, a maximum fine of GHS12,000 may be imposed. Directors and officers of corporate bodies as well as partners of a partnership convicted of an offense may be liable for the offense unless they can prove that it was committed without their knowledge after they had exercised due care and diligence to prevent the offense from being committed.

National Pensions Regulatory Authority

For a breach of the Pensions Act, 2008 (Act 766) which constitutes a criminal offense, a person may be liable on summary conviction to a fine for an amount or to a term of imprisonment specified in relation to the particular breach, or to both. If no penalty is specified, a fine of GHS12,000 or term of imprisonment of not less than one year or both may be imposed.

For example, a trustee, pension fund manager, custodian or director who misappropriates pension funds is liable on summary conviction to a fine of an amount equal to three times the amount misappropriated or to a term of imprisonment not less than ten years or to both. Directors and officers of corporate bodies convicted of an offense may be liable for the offense unless they can prove that it was committed without their knowledge after they had exercised due care and diligence to prevent the offense from being committed.

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

Nominal stamp duty is payable on the advance of a loan exceeding GHS50. No stamp, registration or transfer tax is payable on the transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Stamp duty and registration fees are payable on the taking, transfer or assignment of a mortgage, debenture or other security. Unless a mortgage or other charge is registered at the Collateral Registry and, if created by a company over its property, at the Companies Registry, it is void and ineffective as security.

Mortgages created in respect of land must similarly be registered at the Land Title Registry to be effective.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?
Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Secured lenders and secured debt security holders take priority over the Ghana Revenue Authority on the enforcement of security. However, in the event of a windup of a corporate body, taxes owed to the government or any local authority which became due and payable within the year preceding the date of the commencement of the winding-up will have priority over claims of debentures holders under any floating charge created by the company.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Yes, withholding tax is payable on interest payments under a loan where the payment has a source in Ghana.

If so:

What is the rate of withholding?

The rate of withholding is 1% in the case of interest paid to an individual, or 8% in every other case.

What are the key exemptions?

Key exemptions are:

• interest payments made by an individual, unless made in the course of business;
• interest paid to a resident financial institution; and
• where the payment is an exempt amount under the Income Tax Act, 2015 (Act 896), such as capital gains from the realization of securities traded on the stock exchange up to December 2021.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

The following are exempt from the payment of tax:

• interest paid to individuals:
  • by resident financial institutions; and
  • on government bonds;
• interest paid to a holder of an investment in a unit trust; and
• interest paid to a non-resident on government bonds.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not
otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

Key contacts

Kizzita Mensah
Partner
Reindorf Chambers
kizzita.mensah@reindorfchambers.com
T: +233 302 225 674
Hungary
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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Hungarian and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Hungary or to request that they are admitted to trading on a regulated market operating in Hungary unless an approved prospectus has been made available to the public.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Hungary are bonds issued on a stand-alone basis or under a program.

The private offering of debt securities must take place through an investment firm or credit institution which is authorized to provide those services, with the exception of:

- a credit institution or investment firm offering its own securities;
- a non-resident credit institution or a non-resident investment firm offering its own securities through a branch; or
- an investment fund manager offering the investment units of the investment fund it manages.

Similar rules apply to public offerings. The issuer or the offeror shall procure the services of an investment service provider for organizing and conducting the procedure for the public offering of securities, unless:

- the provisions of the Act CXX of 2001 on the Capital Market (Capital Markets Act) pertaining to public offering applies (in the case of admission to trading on a regulated market);
- the government securities are offered by the issuer itself;
- an investment fund manager offers the investment units of an investment fund it manages;
- a credit institution or investment firm offers to issue its own securities;
- a non-resident credit institution or a non-resident investment firm offers its own securities through a branch;
- the provisions of the Capital Markets Act pertaining to public offering apply (only in the case of registration in a multilateral trading facility), and shares of the same class and type have already been registered previously in the same multilateral trading facility; or
- the provisions of the Capital Markets Act pertaining to public offering apply (only in the case of registration in a multilateral trading facility), and shares of the same class and type have already been registered previously in the same multilateral trading facility; or
facility), and the securities to be registered, issued as part of a series have already been admitted to trading on a regulated market or on a stock exchange established in an OECD member state.

The different types of debt securities offered in Hungary include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (ie debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

**What are the differences between offering debt securities to institutional / professional or other investors?**

The Prospectus Directive does not make a distinction between professional and other investors for the purposes of its disclosure requirements but does include different disclosure regimes by reference to the minimum denomination of a single security.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the 'wholesale' rules apply. If the denomination is under €100,000, the 'retail' rules apply. Additional disclosure requirements apply for retail securities.

**When is it necessary to prepare a prospectus?**

Under the Prospectus Directive, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer is deemed not to have been made to the public if:

- securities are offered only to qualified investors;
- securities are offered to less than 150 persons in each EU member state who are not considered to be qualified investors;
- securities are offered to investors who each purchase securities for a total consideration of at least €100,000, or its equivalent in any other currency;
- the face value of the securities offered is at least €100,000, or its equivalent in any other currency;
- the total consideration for all securities in the EU included in the offer shall not exceed €100,000, or its equivalent in any other currency, within twelve months from the date of announcement of the offer; and/or
- a limited company is created by the transformation of a cooperative society and its shares are offered only to the members and shareholders of the predecessor.

Even if the offer is deemed not to be made to the public, a Prospectus Directive compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and
the admission to trading on a regulated market is required in order to avoid having to publish a prospectus.

**What are the main exchanges available?**

The Budapest Stock Exchange has two principal sections on which debt securities are traded:

- debt securities section (cash market); and
- futures and options section (derivatives market).

**Debt securities section**

Debt securities represented in the debt securities section of the Budapest Stock Exchange include government debt securities (treasury bills and government bonds), corporate bonds and mortgage bonds.

**Derivatives section**

The derivatives section of the Budapest Stock Exchange consists of futures and options contracts based on single stocks, equity indices, FX and interest rate.

**Is there a private placement market?**

Hungary has a relatively active private placement market but there is no dominant standard for documentation.

**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Issuers, offerors and distributors are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to (joint and several) civil liability under Hungarian law.

**Investing in debt securities**

If the prospectus has been supplemented during the public offering of securities any investor who has subscribed for securities or entered into an agreement to purchase securities before the supplement was made available to the public shall be entitled to cancel his declaration of subscription or withdraw from the agreement. The investor may exercise the right of withdrawal within two working days from the date when the supplement was published.

**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**

**Generally**

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the Act XVI of 2014 on Collective Investment Trusts and Their Managers, and on the Amendment of Financial Regulations and is therefore subject to
regulation by the National Bank of Hungary.

**Collective Investment Trusts**

The regulations apply to activities undertaken in relation to 'Collective Investment Trusts' which means any form of collective investment which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors.

*Last modified 20 Oct 2017*

**What are common fund structures?**

An investment fund may be established:

- in the form of private or public investment funds, depending on the mode of placing investment units on the market (form of operation);
- based on the sphere of potential investors, in the form of an investment fund offered to professional or retail investors (mode of marketing);
- in the form of open-ended or closed-ended investment funds, according to the type of redemption of their investment units (type of investment fund);
- for a fixed or unfixed term (maturity of the investment fund);
- in the form of securities fund, real estate fund, venture capital fund or private equity fund, based on the primary assets in which the investment fund may invest (type of primary category of assets); and
- on the basis of harmonization as Undertakings for Collective Investment in Transferable Securities (UCITS) or Alternative Investment Fund (AIF) (type of harmonization).

*Last modified 20 Oct 2017*

**What are the differences between offering fund securities to professional / institutional or other investors?**

**Retail funds**

The investment units of securities funds and real estate funds may be offered to professional and retail investors alike.

**Institutional/professional funds**

Venture capital funds and private equity funds may be established for fixed periods by the private offering of non-redeemable investment units to professional investors exclusively.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

There are no other specific issues to mention here for the purposes of this site.

**Investing in funds**

There are no other specific issues to mention here for the purposes of this site.

*Last modified 20 Oct 2017*
Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Undertakings for Collective Investments in Transferable Securities (UCITS)

UCITS, including those established in Hungary, have an EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Managers Directive, marketing is defined as: a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under an EU passport or if it complies with national private placement regimes (where available).

Reverse solicitation and the definition of ‘marketing’

The Alternative Investment Fund Managers Directive generally continues to permit professional investors who wish to invest in AIFs based on their own initiative (reverse solicitation); however, the EU is currently reviewing this area during 2017 and may impose more stringent requirements.

Specifically in Hungary, Act XVI of 2014 on Collective Investment Trusts and Their Managers, and on the Amendment of Financial Regulations defines marketing as a direct or indirect offering or placement at the initiative of the investment fund manager or on behalf of the investment fund manager of collective investment instruments of a collective investment trust it manages for investors domiciled, or with a registered office, in the EU.

Are there any restrictions on managing a fund?

Fund management in Hungary is regulated under Act XVI of 2014 on Collective Investment Trusts and Their Managers, and on the Amendment of Financial Regulations. The National Bank of Hungary is responsible for regulating funds, fund managers and those marketing funds and any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive (as implemented in Hungary) and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the Undertakings for Collective Investment in Transferable Securities Directive. Full National Bank of Hungary registration involves a significant authorization process which among others must include information on senior personnel (must be suitable persons etc), organizational structure, policies and procedures and remuneration practices.

However, AIFMs based in Hungary can be exempted from full regulation on certain grounds, including managing assets under €500 million where assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers must still register with the regulator.
Entering into derivatives contracts

*Are there any restrictions on entering into derivatives contracts?*

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in Hungary (such as a dealer) will ordinarily have to be authorized by the National Bank of Hungary if the transaction is one of the specified activities set out in the applicable legislation such as:

- options;
- futures;
- contracts for difference; or
- rights to or interests in investments.

The [European Market Infrastructure Regulation](#) applies to all derivative transactions and requires transactions to be reported to regulators and for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

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*What are common types of derivatives?*

Derivative contracts are entered into in Hungary for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in Hungary:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Hungary are:

- foreign currency;
- equity;
- fixed income instruments; and
- commodities.

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*Are there any other notable risks or issues around entering into derivatives contracts?*

Since the global financial crisis in 2007 and 2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought, in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.
As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

**Debt finance**

**Lending and borrowing**

*Are there any restrictions on lending and borrowing?*

**Lending**

Lending in a business-like manner is a regulated activity in Hungary, therefore a lender will need to be authorized by the National Bank of Hungary to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis; and
- to deal with borrowers who fall behind with their payments.

Regulated credit agreements on the other hand have specific requirements regarding how the agreement is drafted and formatted and what information must be included.

There are no additional restrictions that apply to foreign lenders making loans to Hungarian borrowers.

**Borrowing**

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

**What are common lending structures?**

Lending in Hungary can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate members taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, e.g., term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

**Loan durations**

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
• a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
• an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
• a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:
• committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers (as opposed to consumer borrowers) is subject to less regulatory oversight and is therefore less burdensome from a compliance perspective.

By contrast, stricter rules shall apply in case of lending in the context of mortgages and to consumers. For more information, see Lending and borrowing – restrictions.

Do the laws recognize the principles of agency and trusts?

Yes, as of 2013 both principles are recognized as a matter of Hungarian law, however, no significant court practice has been established yet regarding these legal instruments.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. For example, Hungarian courts will not enforce an excessive penalty and so lenders have to be careful about the rate of default interest charged on a loan. Lenders therefore tend to opt for a modest uplift of around 2% above the usual rate.

Specific types of lending
Specific to the area of mortgage lending is the issue of whether a lender falls within the Hungarian mortgage regime. The Mortgage Credit Directive, as implemented in Hungary, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

**Standard form documentation**

Major syndicated finance transactions under the laws of Hungary are governed by documentation based on recommended forms published by the [Loan Market Association (LMA)](https://www.lma.net). Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

*Last modified 20 Oct 2017*

**Are there any other notable risks or issues around borrowing?**


The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Hungarian or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

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**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**

Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and that there are no restrictions on the directors’ powers that would be preventative.

**Insolvency**

Guarantees and security may be at risk of being set aside under the insolvency laws of Hungary if the guarantee or security was granted by a company within a certain period of time prior to the onset of insolvency.

Under Hungarian law, the creditor, and on behalf of the debtor, the liquidator may file for legal action before the court within 90 days from the time of gaining knowledge or within a one-year limitation period from the date of publication of the notice of liquidation to contest certain contracts entered into by the debtor prior to the onset of insolvency.

**Financial assistance**

Public companies limited by shares may provide financial assistance to third parties for the acquisition of shares issued by the public
company limited by shares only under market conditions, from the assets available for the payment of dividends and provided that the
general meeting has approved such decision by at least a three-quarters majority upon recommendation by the management board. No
financial assistance restrictions apply for other corporate forms.

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What are common types of guarantees and security?

Common forms of guarantees

Unless the parties agree otherwise, under the general rules of the Hungarian Civil Code the guarantee contract, and the statement of
guarantee means a guarantor's commitment under which payment is to be made to the creditor subject to the conditions laid down in the
statement. The obligation of the guarantor set out in the statement of guarantee is independent of the underlying obligation of the
debtor. The guarantor may not raise the same objections that can be made by the debtor against the creditor. The guarantor is liable to
make payment under the guarantee if the creditor requested payment in writing, strictly abiding by the requirements specified in the
statement of guarantee.

Common forms of security

There are three basic types of security interest that can be created under the laws of Hungary:

- a pledge;
- a charge; and
- a mortgage.

Different types of security are suitable for securing different types of assets.

Under Hungarian law it is possible to grant security over all of the assets of a Hungarian company or over individual assets. Granting
security over all of a company's assets will tend to be achieved by way of a pledge agreement which will include:

- a mortgage over real estate;
- a pledge over assets which are identifiable and can be controlled by the creditors (such as equipment);
- a pledge over assets identified by detailed description (such as stock); and
- an assignment or pledge over receivables and rights.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing and signed by the guarantor.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations will
usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the
underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this
should not be an issue. It can also be difficult to establish consideration for a guarantee as the primary obligations are between the
underlying obligor and beneficiary, for example between the borrower and lender.

Giving or taking security

Once granted, certain forms of security need to be properly perfected before they are valid against third parties. Perfection formalities can
range from having the secured asset delivered to the security holder, registration of the security and notice being given to third parties.
Most charges created by a Hungarian company must be registered at the public registry within 15 days of its creation.

Like guarantees, for a period after a new security interest has been granted (known as the hardening period), it is at risk of being set aside in certain circumstances under Hungarian insolvency laws. Reviewable transactions include those conducted at an undervalue or preferences.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Act CXXXIX of 2013 on the National Bank of Hungary (2013. évi CXXXIX. törvény a Magyar Nemzeti Bankról) (regulates the primary objectives, basic tasks and responsibilities of the National Bank of Hungary)

Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (2013. évi CCXXXVII. törvény a hitelintézetekről és a pénzügyi vállalkozásokról) (regulates the obligations of credit institutions and financial enterprises regarding their establishment and operation)

Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities (2007. évi CXXXVIII. törvény a befektetési vállalkozásokról és az arutzsai szolgáltatókról, valamint az általuk végezhet tevékenységek szabályairól) (regulates the obligations of investment firms and commodity dealers regarding their establishment and operation)


Act CXX of 2001 on the Capital Market (2001. évi CXX. törvény a tőkepiacról) (regulates the capital markets and the obligations of the market participants thereof)

Act XXX of 2014 on the further development of the system of institutions strengthening the security of the individual players of the financial intermediary system (2014. évi XXX. törvény a pénzügyi közvetítrendszer egyes szereplőinek biztonságát erősíti intézményrendszer továbbfejlesztéséről) (stipulates provisions regarding the financial stability of the financial sector and establishes the framework for the administrative restructuring of financial institutions)

Consumer credit

Act CLXII of 2009 on Consumer Credit (2009. évi CLXII. törvény a fogyasztónak nyújtott hitelről) (consumer lending and the rights and obligations of the lenders and consumers)

Mortgages

Mortgage Credit Directive (2014/17/EU) (mortgage credit)

Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds (1997. évi XXX. törvény a jelzálog-hitelintézetekről és a jelzáloglevélről) (regulates the establishment and operation of mortgage loan companies and the use of mortgage bonds)

Corporations

Act V of 2013 on Civil Code (2013. évi V. törvény a Polgári Törvénykönyvről) (body of rules regulating the core areas of private law)

Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings (2006. évi V. törvény a cégnilvánosságról, a bírósági cégeljárásról és a végelszámolásról) (establishes the legal framework regarding the foundation and
registration of companies and for providing full public access to information from registers of official company records)

Act CXXXII of 1997 on Hungarian Branch Offices and Commercial Representative Offices of Foreign Companies (1997. évi CXXXII. törvény a külföldi székhely vállalkozások magyarországi fióktelepeiről és kereskedelmi képviseleteiről) (business establishment for foreign companies)


**Funds and platforms**


**Other key market legislation**

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)

Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)


**Regulatory authorization**

**Who are the regulators?**

The National Bank of Hungary is the conduct regulator for firms providing financial products and services in both retail and wholesale markets, and also the prudential regulator for many firms. It is also responsible for enforcing the market abuse and listing regimes.

The National Bank of Hungary is also responsible for the prudential regulation of systemically important financial institutions, including banks, building societies, insurers and major investment firms.

**What are the authorization requirements and process?**

All financial institutions/investors must apply to the National Bank of Hungary for authorization.

According to the general rule, the regulators must assess whether the application meets the required threshold conditions within three months of the submission of the completed application, however, in certain circumstances the three-month period might be extended on one occasion by up to a further three months.

The regulator will also approve key individuals (eg senior management) in their roles.

Authorized firms and individuals are listed on the Registry of the National Bank of Hungary.

**What are the main ongoing compliance requirements?**

Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.
Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and a loss of regulated status.

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**What are the penalties for failure to be authorized?**

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment.

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**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

Under Hungarian law, carrying on finance and investment activities by way of business is subject to government authorization. By way of business shall mean gainful (for-profit) economic activities performed on a regular basis for compensation, involving the conclusion of deals which have not been individually negotiated.

The following financial and investment activities are subject to authorization:

- financial services and financial auxiliary services (such as taking deposits and receiving other repayable funds from the public, credit and loan operations, financial leasing, money transmission services or the issuance of electronic money);
- investment services, investment ancillary services and commodity exchange services (such as dealing on own account, portfolio management, granting credits and loans to investors or investment research and financial analysis); and
- services provided under the Act CXX of 2001 on the Capital Market (such as the activities of any stock exchange, central securities depository, central counterparty established in Hungary)

**Consumer credit**

Consumer credit activities, including credit broking, operating an electronic system in relation to lending and entering into a regulated credit agreement as lender are regulated activities.

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**Are there any possible exemptions?**

As a general rule, every person carrying out finance and/or investment activities must apply for authorization, however, certain entities, such as the European Investment Fund or European Investment Bank are exempt from this obligation.

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**Do any exchange controls or other restrictions on payments apply?**

Hungary does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in and out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

There may also be anti-money laundering and tax considerations to take into account.
What are the rules around financial promotions?

Under Hungarian law, the communications by financial institutions are subject to special consumer protection provisions governing the form and content of financial promotions. These provisions stipulate that financial promotions shall be clear about the key conditions, shall not be misleading and shall not create unrealistic expectations.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are companies limited by shares and limited-liability companies, both of which are body corporates with separate legal personality that limit the liability of their members.

Companies limited by shares can either be private (denoted by the suffix 'Zrt.') or public (denoted by the suffix 'Nyrt.') depending on whether their shares are offered to the public. Some activities require a particular type of legal entity to be used, for example banks and specialized credit institutions may only operate in the form of companies limited by shares or as branches.

The liability of a company's shareholder is limited by shares, in which case they are only liable to pay for their shares and not the company's debts.

Limited-liability companies (or 'Kft.') are similar to companies limited by shares in many ways. The main difference is that they require a lower minimum initial capital contribution.

Funds

Investment funds are recognized as legal entities, and shall be deemed established when registered by the National Bank of Hungary, and shall be deemed terminated when removed from the register. In its capacity as the investment fund's lawful representative, an investment fund manager may act in the name of the investment fund.

Investment fund managers (with certain exceptions) typically operate in the form of companies limited by shares.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A company can conduct lending or investment business in Hungary through an establishment (also known as a 'branch') but this does not create a separate legal entity.

Overseas companies having an establishment in Hungary need to comply with the Act CXXXII of 1997 on Hungarian Branch Offices and Commercial Representative Offices of Foreign Companies.

Overseas companies carrying on a trade in Hungary through a 'permanent establishment' will be subject to Hungarian corporation tax.
FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P) type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus.
that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned'). Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example the most widely-known alternatives to bitcoin being ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of
access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The National Bank of Hungary (National Bank) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets, and also the prudential regulator for many firms. It is also responsible for enforcing the market abuse and listing
regimes.

GENERAL

Under Hungarian law, carrying on finance and investment activities by way of business is subject to government authorization. All financial institutions/investors must apply to the National Bank for authorization. The National Bank will also approve key individuals (e.g. senior management) in their roles. Authorized firms and individuals are listed on the Registry of the National Bank. Where FinTech products and/or applications involve financial activity which requires regulatory authorization, the firms providing such products and/or applications must be authorized by the National Bank.

REGULATORY DEVELOPMENTS ON INVESTMENT PLATFORMS

The Hungarian regulatory framework on investment platforms follows the direction of European Union developments.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

Act CCXXXV of 2013 on Payment Service Providers (Payment Service Act) regulates the establishment and the operation of electronic payment platforms. A number of FinTech businesses are offering electronic payment platforms to rival the traditional payment systems. The Payment Service Act and Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (Financial Institutions Act) contain a number of electronic money (e-money)-related rules, aimed at businesses that are issuing or considering the issuance of e-money. E-money is defined by the Financial Institutions Act as electronically, including magnetically, stored monetary value as represented by a claim on the issuer of the e-money which is issued on receipt of funds for the purpose of making payment transactions, and which is accepted by a natural or legal person, unincorporated business association or private entrepreneur other than the e-money issuer. Generally, firms issuing e-money must be authorized or registered with the National Bank.

PEER-TO-PEER LENDERS

A person carries out a regulated activity (requiring authorization by the National Bank) if they facilitate lending and borrowing on a commercial scale.

Regulation of payment services

Under Hungarian law, carrying on finance and investment activities by way of business is subject to authorization. By way of business means gainful (for-profit) economic activities performed on a regular basis for compensation, involving the conclusion of deals which have not been individually negotiated. In order to become authorized by the National Bank, a payment services business needs to meet certain criteria, including in relation to its business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

Application of data protection and consumer laws

The Act CXII of 2011 on the Right of Informational Self-Determination and on Freedom of Information (Data Protection Act) regulates the processing of personal data within Hungary. The Data Protection Act implements the European Data Protection Directive. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the Data Protection Act and have certain notification and compliance obligations. In addition, Act CVIII of 2001 on Electronic Commerce and on Information Society Services stipulates further data protection provision related to transactions made through electronic commerce.

The European General Data Protection Regulation (GDPR) is set to come into effect on 25 May 2018. The GDPR is more prescriptive and restrictive compared to the Data Protection Act, including mandatory notifications where a breach occurs and provides for severe monetary sanctions for breach.

Money laundering regulations

Act LIII of 2017 on the Prevention and Combating of Money Laundering and Terrorist Financing gives the National Bank responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment. These regulations implement the European Union's Fourth Money Laundering Directive.
Generally, where a firm is authorized and supervised by the National Bank it will also be authorized and supervised by the National Bank for complying with anti-money laundering requirements. Electronic currencies such as bitcoin and cryptocurrencies tend to represent a higher money-laundering risk.

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**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

**ACCELERATORS**

There are various incubators or accelerators in the Hungarian market which offer support, facilities and funding for startups, often in return for an equity stake.

**Venture capital and debt**

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a loan (or series of loans) secured against a company’s assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.
Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks.

**Senior bank debt and capital markets funding**

**Senior Bank Debt**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**Capital Markets Funding**

Raising finance by way of an Initial Public Offering (IPO) is a possible funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the Budapest Stock Exchange.

**Convertible Bonds/Loan Notes**

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

**Incentives and reliefs**

As of 1 January 2017, the Act LXXXI of 1996 on Corporate Tax and Dividend Tax offers a corporate tax relief for businesses who invest in the shares of qualifying startups, up to a maximum amount of HUF 20 million per year for three years, following the acquisition of the shares.

**Portfolio sales**

**Loan transfers and portfolio sales**

*What are common ways of buying and selling loans?*

Buying and selling loans is not very common in Hungary.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Transfer of contract** – The transfer of the contract is a full legal transfer of the party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in the transfer of the contract between the continuing party and the transferee and the transferor being released from its obligations. The debtor can grant a prior approval to such transfer.

- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

*What are the main considerations when transferring a loan and related security?*
There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

Projects

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Hungary varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, roads and waste); and
- social infrastructure (education, health and justice/prisons and housing).

Key sectors are considered below.

**Energy**

The liberalization of the Hungarian electricity and natural gas market was completed in 2008, with generation, transmission, distribution and supply services provided by a number of private sector companies. Private sector companies own such generation assets, however, transmission and distribution assets are owned by the state owned MAVIR Hungarian Independent Transmission Operator Company Ltd.

The public sector finances and delivers most of the required infrastructure but there are a number of private sector investments, mainly in connection with the renewable and smaller scale co-generation energy generation technologies.

The Hungarian Energy and Public Utility Regulatory Authority (MEKH) is the principal body with responsibility for regulation of the energy sector in Hungary.

**Telecoms infrastructure**

The telecommunications networks (fixed and mobile) in Hungary are privately owned by a number of incumbent service providers. A good example is Telekom Hungary which is responsible for most of Hungary's broadband infrastructure but whose work is heavily regulated by government.

The National Media and Infocommunications Authority (NMHH) is the regulator of Hungary's telecommunications sector. It also has responsibilities for television broadcast services and wireless communications services.

**Transport infrastructure**
LIGHT RAIL

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies.

HEAVY RAIL

The rail market in Hungary is dominated by the state owned Hungarian State Railways Ltd. (MÁV). The principal elements to the rail sector in Hungary are:

- Hungarian State Railways Ltd. (MÁV), a private limited company, is on the public sector balance sheet and owns or operates and maintains rail tracks, signaling and station infrastructure. It is responsible for operating most of the regulated national rail infrastructure.

- Freight Operating Companies (FOCs) and Rolling Stock Companies (ROSCOs) are mostly owned by the Hungarian State Railways Ltd.

The rail sector is regulated by the National Transport Authority.

ROADS, BRIDGES AND TUNNELS

A government entity, Hungarian Public Road Non-Profit Ltd, operates, maintains and improves the motorways and major roads in Hungary, and receives funding from the government for investment in the strategic road network (including additional road capacity). Local roads in Hungary are the responsibility of local authorities. Construction contracts are generally procured by the National Infrastructure Developing company NIF Zrt. In the case of toll roads, the private sector has taken on roads/crossings on a full concession basis and is therefore responsible for the design, build, financing, operation, maintenance and collection of tolls for a number of years with the main revenue stream being the collection of toll revenues from users (rather than any service payments from the public sector). However, these types of projects are no longer considered viable as the private sector is not willing to take ‘demand risk’ in order to service the upfront capital costs and associated bank debt.

AVIATION

Aviation in Hungary is (for the most part) privatized. As regards airport infrastructure, there are a number of ownership structures in the Hungarian market, including private ownership and local government ownership. All models are heavily regulated by government and the National Transport Authority is the aviation regulator in Hungary.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector (eg ownership of hospitals is vested in various public sector bodies). The majority of social infrastructure assets in Hungary are directly financed by the government.

DEFENSE

Typically, defense assets are owned by the public sector.

WASTE

In Hungary waste related services are provided by the public sector, which is responsible for designing, building, operating and maintaining the facilities and the infrastructure.

WATER

In Hungary water and wastewater services are provided by state owned companies.

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Are there special rules for investing in energy and infrastructure?

Generally
There is no specific regime governing or restricting investment in energy or infrastructure projects in Hungary over and above existing regulation for investors and funders more generally however, a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. Key sector-specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and whether there are any contractual restrictions on change of control, in respect of an existing/operational project. This is less of a concern for private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

**Energy**

The energy markets in Hungary have a complex system of arrangements between suppliers, generators, transmission and distribution which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customers and the MAVIR Magyar Villamosenergia-ipari Átviteli Rendszerirányító Zrt. (the Hungarian transmission system operator) which are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how developments in technology may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.

**Telecoms infrastructure**

There is a complex regulatory environment for this sector including how access and interconnectors (between networks) are regulated under Act C of 2003 on Electronic Communications and other applicable legislation and how The National Media and Infocommunications Authority (NMHH) grants rights to access private or public land in order to install and maintain essential equipment in, over or under that land. This equipment might be cables sunk beneath the ground or a mobile mast sited on the ground.

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

**Transport infrastructure**

**RAIL**

There is an extensive and complex regulatory framework to consider in respect of a practical and operational involvement in this sector. Key areas include understanding the regulatory regime for certification for train use and acceptance and user fare regulation. Depending on how an investor wishes to invest in a project (specifically what type of entity or asset), there is a varying degree of difficulty for investors to enter into an existing project.

**ROADS**

In order for a private sector partner to carry out its duties on certain types of roads projects, the procuring public sector authority may delegate certain of its statutory duties to the private sector partner. This will be dependent on the project and the specific contractual requirements. Any investor will, therefore, need to understand those duties and whether it is able to subcontract those duties to an appropriate person.

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**What is the applicable procurement process?**

Public procurement in Hungary is, in most instances governed by Act CXLIII of 2015 on Public Procurement which is based on EU Directives. There are some sector-specific regulations such as Act XXX of 2016 the Defense and Security Public Procurements, but these are also based on EU Directives.
The key principles are that contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

**Investing in energy and infrastructure**

Public procurement is relevant where the Hungarian government, or any branch of it as a state-owned company, is seeking to outsource the delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. Design, Build, Finance and Operate public-private partnership (DBFO PPP) schemes were popular in Hungary in road, prison, education and sports projects before 2010. Currently, no new DBFO PPP projects are launched and existing DBFO PPP projects are being actively terminated by the state. The relevant procurement legislation applies to certain public bodies including central government departments, local authorities, police and fire authorities and various non-governmental bodies. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures.

**OPEN PROCEDURE**

This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.

**RESTRICTED PROCEDURE**

There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

**COMPETITIVE DIALOGUE**

This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to discuss with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer’s bid.

**COMPETITIVE PROCEDURE WITH NEGOTIATION**

This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

**Financing energy and infrastructure**

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

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**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

Common forms of funding in energy and infrastructure include:
loans made on a corporate finance basis (balance sheet debt);

- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bond finance;
- refinancing of the debt in operational projects; and
- asset financing (particularly relevant in the rail sector).

Funding/funding products can also, sometimes, provided by the European Investment Bank and export credit agencies.

Investing

Common forms of investing in energy and infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of 'equity').

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the National Bank of Hungary considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

What regulatory penalties may apply?

When a rule breach has taken place, the National Bank of Hungary may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

What criminal penalties may apply?

Following formal investigation, the criminal courts have the power to impose criminal penalties in certain cases, including:

- insider dealing;
- unlawful disclosure of inside information;
- unlawful market manipulation;
- organization of pyramid schemes;
- money laundering; and
- unauthorized financial activities.
Tax

Tax issues

*Are stamp, registration, transfer or other similar taxes applicable?*

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Most security interests must be registered with the competent authority to ensure that they are valid against third parties.

The grant of a security interest over Hungarian real estate should be registered at the Land Registry as the competent authority.

Other forms of registration may also be required, depending on the nature of the asset over which the security is taken. In the case of security over shares or business quotas the Court of Registration is the competent authority for registration purposes. Security over certain movable property, rights and claims must be registered on the Collateral Register of which the Hungarian Chamber of Notaries is the competent authority.

Such registration procedures are subject to notional administrative service charges (eg the registration of a mortgage over Hungarian real estate at the Land Registry is subject to a procedural fee of HUF 12,600 (approximately €30) per plot number). Such registrations may also require the payment of notional registration fees.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security. However, the introduction of securities (issued in a series) to the regulated market or the registration in a multilateral trading system may be subject to administrative service charges.

*Do tax authorities take priority on enforcement?*

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

In the case of an enforcement procedure, a mortgage concerning movable or immovable property takes priority over the claims of the tax authority.

In the case of a liquidation procedure, taxes and social security contributions related to employment and termination of employment take priority over debts secured with a mortgage. Other claims of the tax authority related to taxes and social security contributions are subordinated to a debt secured with a mortgage.

*Is withholding tax on interest payments applicable?*

Is there withholding tax on interest payments under a loan?
No withholding tax applies on outbound interest payments made to a corporate entity which is not resident for tax purposes in Hungary, provided that the recipient does not have a permanent establishment in Hungary.

Interest payments made to an individual who is not resident for tax purposes in Hungary are, in general, subject to withholding tax in Hungary.

**If so:**

**What is the rate of withholding?**

Withholding tax is not applicable in the case of interest payments made to a corporate entity which is not resident for tax purposes in Hungary, provided that the recipient does not have a permanent establishment in Hungary.

In general, interest paid to an individual who is not resident for tax purposes in Hungary is subject to 15% withholding tax in Hungary.

**What are the key exemptions?**

Withholding tax is not applicable in the case of interest payments made to a corporate entity which is not resident for tax purposes in Hungary, provided that the recipient does not have a permanent establishment in Hungary.

Relevant double tax treaty provisions may mitigate or provide protection against taxation of outbound interest payments in Hungary in the case of payments made to an individual who is not resident for tax purposes in Hungary.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

*Last modified 20 Oct 2017*

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No, provided that the lender does not have a permanent establishment in the jurisdiction of the borrower (ie in Hungary).

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes.

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**Key contacts**

**Péter Györfi-Tóth**
Partner
Horváth & Partners Law Firm
peter.gyorfitoth@dlapiper.com
T: +36 1 510 1120
Ireland

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Irish and EU law.

Unless certain exemptions apply, it is unlawful to offer debt securities to the public in Ireland. Where an issuer of debt securities is able to avail of one of the exemptions (outlined below), a prospectus will still be required if the Issuer intends to have the securities admitted to trading on a regulated market in Ireland.

Under the Companies Act, 2014 (as amended), a private company limited by shares (LTD) and a designated activity company (DAC) cannot offer securities to the public. However, section 68 (3) of the Companies Act 2014 provides that the offer of certain types of securities by a private limited company will not constitute an offer to the public. They include an offer:

- addressed to qualified investors only;
- addressed to fewer than 150 persons (other than qualified investors);
- addressed to investors who acquire securities for a total consideration of at least EUR100,000 per investor, for each separate offer;
- with a denomination per unit of at least EUR100,000; and
- with a total consideration in the EU of less than EUR100,000, calculated over a 12-month period.

A DAC can, pursuant to section 981 of the Companies Act 2014, apply to have the above securities admitted to trading or listed on any market, regulated or otherwise. An LTD is prohibited from applying to have, and from having securities admitted to trading or listed on any market.

A public limited company can offer debt securities to the public and can apply to have those debt securities admitted to trading and listing, whether on a regulated market or otherwise.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Ireland are bonds or notes issued on a standalone basis or under a program.

Many different types of debt securities are offered in Ireland. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
• asset-backed securities;
• derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
• hybrid securities (securities with both debt and equity features);
• equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
• Capital Contingent Convertibles (CoCos), which can qualify as either Additional Tier 1 (AT 1) or Tier 2 (T2) bonds (all subordinated debt instruments issued by banks to fulfil regulatory capital requirements);
• Restricted Tier 1 (RT1) and Tier 2 (T2) bonds (junior bonds issued by insurance companies to fulfil regulatory capital requirements);
• Sovereign green bonds and corporate public green bonds which comply with the International Capital Market Association’s Green Bond Principles; and
• warrants (securities giving the holders the option to purchase the equity of the issuer or of a related company).

What are the differences between offering debt securities to institutional / professional or other investors?

The Prospectus Regulation (EU) 2017/1129 (the Prospectus Regulation) became directly effective in Ireland from July 21, 2019. Two Delegated Regulations (Commission Delegated Regulations (EU) 2019/980 and Commission Delegated Regulation (EU)2019/979) have also been implemented. The European legislation puts in place a harmonized framework which is intended to ensure investor protection and to drive supervisory convergence at the EU level where securities are offered to the public or admitted to trading on a regulated market in an EU Member State.

Domestic legislation in the form of EU (Prospectus) Regulations 2019 (S.I. No. 380/2019) (the Irish Regulations) was enacted in July 2019. The Central Bank of Ireland also published new rules to replace its existing market abuse, transparency and prospectus requirements and consolidate them into a single statutory instrument. The Central Bank (Investment Market Conduct) Rules 2019 (S.I. No. 366/2019) came into force in July 2019 and are supplemented by guidance documents which are published on the Central Bank of Ireland’s website.

The EU (Prospectus)(Amendment) Regulations 2019 (S.I. No 670 of 2019) increased the threshold of total consideration to EUR8 million for a public offer of securities below which a prospectus would not be required for offers to the public.

The Finance (Tax Appeals and Prospectus Regulation) Act 2019 commenced on December 18, 2019, and amended the prospectus law provisions in Part 23 of the Companies Act 2014 to reflect the transposition of the Prospectus Regulation.

Under the Prospectus Regulation, one of the circumstances in which a prospectus must be produced is where an offer of securities is made to the public within the EU. An exemption from this requirement to publish a prospectus applies where offers are made solely to qualified investors (which are defined as persons or entities under the professional investor classification in the MiFID II Directive (2014/65/EU) (professional clients, persons treated as professional clients, and persons recognized as eligible counterparties)). However, if the debt securities are to be admitted to trading on an EU-regulated market, a prospectus would still be required.

The nature of the information that has to be disclosed in a prospectus for the issue of debt securities under the Prospectus Regulation depends on whether the issue falls within the retail regime or the wholesale regime.

If the denomination of the securities is equal to or above EUR100,000 (or the equivalent in another currency), the wholesale rules apply. If the denomination is under EUR100,000, the retail rules apply. Additional disclosure requirements apply for retail securities.

When is it necessary to prepare a prospectus?

Securities can only be offered to the public in the EU after prior publication of a prospectus in accordance with the Prospectus Regulation. Securities shall only be admitted to trading on a regulated market situated or operating within the EU after prior publication of a prospectus in accordance with the Prospectus Regulation.
An offer would not be deemed to have been made to the public if, among other things, it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per Member State or where the minimum denomination per unit is at least EUR100,000.

Pursuant to the Irish Regulations there is an additional exemption from the obligation to publish a prospectus where the total consideration of the offer does not exceed EUR8 million.

Even if the offer is deemed not to be made to the public, a Prospectus Regulation compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

What are the main exchanges available?

The Irish Stock Exchange joined Euronext in March 2018 and now operates under the trading name Euronext Dublin. Issuers of debt securities can list on either the Euronext Dublin Regulated Market (Regulated Market) or the Global Exchange Market (GEM).

The Regulated Market is a regulated market (as defined under MiFID II) and Euronext Dublin is the authority for the approval of the securities for admission to listing and trading on the Regulated Market.

The GEM is an exchange-regulated market and Multilateral Trading Facility as defined under MiFID II which is aimed at professional investors.

Issuers and debt securities listed on the Regulated Market are subject to the prospectus regime, the transparency regime and the market abuse regime, whereas issuers of debt securities listed on the GEM are subject to the market abuse regime only.

Euronext Dublin has published a comprehensive set of rules for listing a variety of debt securities on the Regulated Market (Euronext Dublin Rule Book – Book II: Listing Rules) and GEM (Global Exchange Market – Listing and Admission to Trading Rules for Debt Securities – Release 6). These rules impose obligations on issuers of debt securities at the time of application for admission to trading and listing, and on an ongoing basis.

Is there a private placement market?

Ireland has an active private placement market. “Private placement” is not a defined term under Irish securities market legislation; however, it is generally described as an offer where securities are made available to a relatively small number of selected investors as a way of raising capital. Essentially, a private placement is one that does not qualify as a public offer and therefore, where any of the exceptions set out in section 68 (3) of the Companies Act 2014 (discussed above) are applicable, the obligation to publish a prospectus would not arise (unless the securities, the subject of the offer, are to be listed on a regulated market).

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Pursuant to Regulation 35 of and the schedule to the Irish Regulations, each of the following persons (i.e. more than one person may be required to take responsibility for the whole of the prospectus) is responsible for the prospectus, where the securities are not equity securities:

- if the case involves an offer of securities to the public, the offeror of the securities;
- if the case involves the admission to trading of securities, the person seeking admission;
• if there is a guarantor in respect of the issue, the guarantor in respect of statements included in, or information omitted from, the prospectus that relate to the guarantor or the guarantee given by the guarantor.

Certain persons can take responsibility for specified parts. This is in addition to the responsibility attaching to the person(s) in (a) to (c) above.

Civil and criminal liability may attach to an issuer for breaches of the prospectus regime, the transparency regime, market abuse regime, including civil and criminal liability under the Companies Act 2014. In addition, the Central Bank of Ireland and/or Euronext Dublin can impose administrative sanctions for breach of the prospectus regime or of the listing rules, as appropriate.

Civil liability for certain claims, including mis-statements or omissions in a prospectus, may also arise under common law.

Civil liability in respect of misstatements under the Companies Act 2014 does not extend to the directors of the issuer or an expert who consented to the inclusion of their statement in the debt securities prospectus, unless the prospectus expressly provides otherwise or unless such person is convicted on indictment of an offence created by the Irish Regulations or an offence under s1357 of the Companies Act in respect of the issue of that prospectus.

Under the Transparency (Directive 2004/109/EC) Regulations 2007 (S.I. 277/2007) (as amended), any person (including a director or secretary) who knowingly or recklessly provides false or misleading information in an attempt to comply with those regulations shall be guilty of an offence. The Irish Regulations also permit the Central Bank of Ireland to impose administrative sanctions for prescribed contraventions as set out therein.

The Market Abuse Regulation (EU596/2014), the Market Abuse Directive on criminal sanctions for market abuse (Directive 2014/57/EU) (transposed into Irish law by the Irish Market Abuse Regulations) (S.I. No 349/2016) together with the Companies Act 2014 provide that civil and criminal liability may attach to the issuer and potentially a director or officer of the issuer who consented to or approved a breach of market abuse law.

Investing in debt securities

The terms and conditions relating to debt securities typically contain provisions permitting minor amendments to be made to transaction documentation without the need to obtain the consent of all investors. The trustee acting on behalf of the investors is usually given the discretion to do this. The terms and conditions also provide for meetings of investors in order to consider matters that could potentially affect an investor's interests. The transaction documents will provide for defined majorities to bind all investors, including those who did not attend and vote and those who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Ireland is regarded as a key strategic location by the world's leading investment funds players; attracting significant levels of foreign investment. It is Europe's top hedge fund domicile and is the largest hedge fund administration centre in the world.

The Central Bank of Ireland is responsible for the authorization and supervision of collective investment schemes established in Ireland, including regulated investment funds and investment managers. Regulated funds and fund service providers must also comply with the Central Bank of Ireland's fitness and probity requirements for persons performing certain prescribed roles within those entities.

What are common fund structures?

Ireland as a domicile provides a number of potential structuring options for funds, which can be broadly categorized as regulated by the Central Bank of Ireland or unregulated.

Regulated Fund Structures
Broadly speaking, each of the regulated fund structures below may be established as either an Undertaking for Collective Investment in Transferable Securities (UCITS), pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011, as amended (the UCITS Regulations) or as an Alternative Investment Fund (AIF), pursuant to the EU (Alternative Investment Fund Managers) Regulations 2013, as amended (the AIFM Regulations), which transposed the Alternative Investment Fund Managers Directive (AIFMD) into Irish law. AIFs are authorized by the Central Bank of Ireland in one of two categories – either as a Retail Investor AIF (RIAIF), which may be marketed to retail investors, or as a Qualifying Investor AIF (QIAIF), which may be marketed to qualifying investors.

An application for authorization of a UCITS or an AIF must be submitted for review and approval to the Central Bank of Ireland. It needs to be accompanied by certain information (including the relevant Central Bank of Ireland application forms, the draft fund documentation and any draft letters relevant to the application).

The main types of regulated fund structures in Ireland are set out below. Other than the ILP, which can only be used for AIFs, each of these fund structures are suitable for UCITS and AIFs.

(I) THE ICAV

The ICAV, established in 2015, is quickly becoming the vehicle of choice for Irish funds. It is an Irish corporate investment fund which was introduced pursuant to the Irish Collective Asset Management Act 2015 to meet the needs of the global funds industry. Since its creation, the ICAV has replaced the Investment Company as the most commonly used structure for newly established funds. The ICAV is a tailored corporate structure that is specifically designed to give more administrative flexibility than an Investment Company.

An ICAV may be established as an umbrella structure with a number of sub-funds and share classes. In an important innovation, it is possible to prepare accounts per sub-fund. It is not subject to those aspects of company law which are irrelevant to, or inappropriate for, collective investment schemes (thereby helping to reduce administrative burden and costs). Establishing an ICAV involves a two-stage process. The ICAV must first be registered with the Central Bank of Ireland and then authorized as either a UCITS fund pursuant to the UCITS Regulations or an AIF pursuant to the AIFM Regulations. In addition, and unlike Investment Companies, the ICAV can elect to be treated as a tax transparent entity for US federal income tax purposes. UCITS and AIFs that are established in Ireland as Investment Companies can convert into ICAVs, in accordance with a conversion process provided for by the Central Bank of Ireland. The ICAV legislation also provides for ICAV mergers and for the migration of funds domiciled outside Ireland into Ireland as ICAVs by continuation.

(II) THE INVESTMENT COMPANY

An Investment Company is established as a public limited company under the Companies Acts 2014. This entity has a separate legal identity and there is no recourse to its shareholders. However, there is a statutory requirement for an investment company to spread risk, under Part 24 of the Companies Act 2014.

(III) THE UNIT TRUST

A Unit Trust is not a separate legal entity but rather a contractual fund structure constituted by a trust deed between a trustee and a management company. With this structure, the trustee or its appointed nominee acts as legal owner of the fund’s assets. As the Unit Trust does not have a separate legal personality, it cannot contract for itself.

This is a common form of fund vehicle, available for both UCITS and AIFs. While this vehicle is often used by fund managers who are marketing a fund to Irish, UK, US or Japanese investors (as many civil law jurisdictions do not recognize the trust structure), it is not typically used by promoters who wish to sell their funds to continental European investors (who have traditionally preferred the investment company structure).

(IV) INVESTMENT LIMITED PARTNERSHIPS (ILPS)

An ILP is established pursuant to the Investment Limited Partnership Act 1994. This structure has not proven popular in Ireland and has been used infrequently. It is available only for AIFs. An ILP is a partnership and as with a Unit Trust, an ILP does not have an independent legal existence. It has one or more limited partners (similar to shareholders in an Investment Company or ICAV, or a unitholder in a Unit Trust), and a general partner that can enter into contracts on behalf of the ILP. The ILP is recognized under the laws of a number of countries, including the US, as a tax-transparent entity. In June 2019, the Irish government published the Investment Limited Partnership (Amendment) Bill 2019, which proposes to reform and modernize the legislation in relation to ILPs, bringing the regime in line with those
in other leading jurisdictions and making Ireland an attractive domicile for the establishment of ILPs. The changes proposed include the establishment of umbrella ILPs and clarifying and expanding safe harbors to allow limited partners to undertake certain actions without being deemed to take part in the management of ILPs.

(V) COMMON CONTRACTUAL FUNDS (CCFS)

A CCF, similar to a Unit Trust and investment limited partnership, does not have a separate legal existence. It is a contractual arrangement established under a deed of constitution, giving investors the rights of co-owners of the assets of the CCF. As co-owners, each investor in a CCF is deemed to hold an undivided co-ownership interest in the assets of the CCF, as a tenant in common with other investors.

A CCF is essentially a facility whereby investors may pool their resources to enable them to be commonly managed for investment purposes provided certain investor criterion are met. Importantly, the CCF is treated as being transparent for Irish tax purposes as long as all of its investors are institutional investors.

Unregulated Fund Structures

(I) LIMITED PARTNERSHIPS (LPS)

A limited partnership established pursuant to the Limited Partnership Act 1907 is a popular structure for unregulated investment funds in Ireland. An LP is a partnership between one or more general partners and one or more limited partners, which is constituted by a partnership agreement. To have the benefit of limited liability, only the general partner is permitted to engage in the management of the business of the partnership, or to contractually bind the partnership. LPs are tax transparent and do not have separate legal personality.

There is a general limit of 20 partners in a limited partnership or 50 where the partnership is formed "for the purpose of, and whose main business consists of, the provision of investment and loan finance and ancillary facilities and services to persons engaged in industrial or commercial activities." Limited partnerships are commonly used on financing transactions. They often sit under regulated fund structures (please see discussion on ICAVs above). They are frequently used by promoters of Irish regulated funds as they are treated as "look through" entities from a tax perspective. The partners of the limited partnership are instead subject to tax on their profit share, as provided for in the partnership deed.

Another reason limited partnerships are used in these structures is that they help create a separate security package in a sub-fund structure where limited recourse financing is being provided. Multiple limited partnerships can be used under one sub-fund, thus creating a separate security package for lenders and reducing the set-up and ongoing costs of multiple sub-funds.

(II) SECTION 110 COMPANIES

A section 110 company is an Irish resident special purpose vehicle that holds and/or manages what are known as "qualifying assets" (as defined in the Taxes Consolidation Act 1997). Qualifying assets include a wide range of financial assets, commodities and plant and machinery.

The main benefit of a Section 110 company is that it is generally entitled to claim a tax deduction for all of its financing expenses, including (subject to some conditions) its profit-linked financing expenses. Therefore, it is in general possible to ensure that a section 110 company can acquire assets using debt financing on a tax neutral basis by ensuring that the section 110 company pays out all of its return in respect of those assets as tax deductible interest payments to lenders and investors.

Section 110 companies are widely used by international lenders, asset managers and investment funds for a variety of transactions, including, securitizations, CLOs, CDOs, bond issuances in the capital markets and as onshore investment platforms. They are also frequently used to hold and lease qualifying plant and machinery, such as aviation and shipping assets. Ireland is regarded as a center of excellence for aircraft financing and leasing and Section 110 companies are frequently used for structuring on such transactions.

In addition, a Section 110 company qualifies for the benefits of Ireland's double tax treaty network which should reduce or eliminate withholding taxes on income flows and capital gains in treaty jurisdictions.

What are the differences between offering fund securities to professional / institutional or other investors?
There are various differences which arise depending on whether securities are being offered to professional/institutional or other investors. These differences, and the various fund structures that are typically used, are explored further below.

**Retail**

**UCITS**

Open-end retail funds must be either authorized or recognized (if domiciled in another jurisdiction) by the Central Bank of Ireland. Funds that are recognized in this context are usually UCITS, which are collective investment schemes established and authorized under a harmonized EU legal framework. Under this framework, a UCITS established and authorized in one EU Member State holds what is termed the "European passport," allowing it to be sold cross-border into other EU Member States without further authorization. This enables fund promoters to create a single product for the entire EU rather than having to establish an investment fund product on a jurisdiction by jurisdiction basis. Ireland is one of the world's leading domiciles for cross-border UCITS.

UCITS are aimed at the retail market. They are a regulated retail investment product, subject to various liquidity constraints, investment/asset class restrictions (both in terms of permitted investments and required diversification) and borrowing and leverage limits. UCITS are structured as open-ended, diversified and liquid products. Although designed principally for the inexperienced investor, they are often sold across the full spectrum of investor types, including institutional investors.

UCITS are subject to a simple registration process and the EU framework mentioned above means they do not need to comply with local securities laws in each Member State. They can also be sold globally and can be restricted to institutional investors if the promoter wishes.

**RIAIF**

A RIAIF is an AIF authorized by the Central Bank of Ireland aimed at non-professional/institutional investors. It does not have a regulatory minimum subscription. The Central Bank of Ireland has set out the general investment and borrowing restrictions applicable to RIAIFs in its AIF Rulebook. As a retail fund, a RIAIF does not have the automatic right to any marketing passport and access to individual markets is granted on a case-by-case basis only. RIAIFs must appoint a fully authorized AIFM and non-EU managers or registered AIFMs are prevented from managing RIAIFs.

A RIAIF is subject to fewer investment and eligible asset restrictions than UCITS, but a more restrictive regime than the QIAIF (discussed below). There is a restriction on a RIAIF borrowing more than 25% of its net assets.

**Institutional/professional funds**

**QIAIFS**

Non-retail funds that are offered in Ireland are usually authorized as QIAIFS and subject to the AIF regime in relation to authorization of the manager/fund, marketing arrangements, reporting and governance.

QIAIFS are authorized by the Central Bank of Ireland to be marketed only to what are termed qualifying investors (i.e. sophisticated and institutional investors). A QIAIF is subject to a minimum initial subscription requirement of EUR100,000 (or equivalent in other currencies) per investor and investors must meet certain appropriate expertise/understanding tests in order to invest. A QIAIF is the most frequently used non-UCITS vehicle due to its greater flexibility in terms of investment, leverage and borrowing limits (though it is obliged to spread risk if established as an Investment Company). Ireland's tax regime provides that Irish QIAIFs are not subject to Irish tax on their income, gains or dividend payments to non-Irish investors.

A QIAIF must appoint a depositary and also an alternative investment fund manager (AIFM). In addition, the status of its AIFM determines how the QIAIF can be managed and where and how it can be marketed. A QIAIF can avail of the right to market across the EU, using an AIFMD passport, and can either be managed by an EU or non-EU AIFM and/or internally managed (discussed further below). A QIAIF can also be marketed freely to professional investors throughout the EU Member States (and the three additional European Economic Area Members States) by an authorized AIFM using an AIFMD marketing passport.

A QIAIF is suitable for hedge funds, less liquid and illiquid alternatives, private equity, venture capital, development capital and real estate funds (as well as most other types of investment fund exposure).

Real Estate Investment Trusts (REITs) were introduced in Ireland in 2013, with a view to stabilizing the local property market at a time when it was stagnating due to the fiscal crisis. Although REITs are not collective investment undertakings, the Central Bank of Ireland has indicated that they will generally be regarded as AIFs for the purposes of AIFMD (and therefore require an AIFM) unless the REIT can
demonstrate that this should not be the case.

In broad terms, a REIT must reside in Ireland for tax purposes, be incorporated under the Companies Act 2014 and list its shares on the main market of a recognized stock exchange in a Member State of the EU. As REITs are intended to provide risk diversification and after tax returns to investors, they must hold at least three properties and no one property may account for more than 40% of the total value of the property in the relevant REIT. Once incorporated, the trust can gain classification as a REIT from the Irish Revenue Commissioners when certain conditions are satisfied. In order to classify as a REIT, the trust must (among other things) derive at least 75% of its profits from property rental and distribute at least 85% of its rental profits to shareholders. Once classification is obtained, the REIT is exempt from corporation tax on qualifying income and gains from rental property.

UCITS structures are not appropriate for REITs, as UCITS may not invest directly in real estate, must focus on liquid assets and are required to provide at least twice monthly redemption facilities. Accordingly, the appropriate structures for real estate funds are non-UCITS structures.

Are there any other notable risks or issues around establishing and investing in funds?

Irish investment funds may be open-ended, open-ended with limited liquidity or closed-ended. Accordingly, the risks/issues that arise around establishing or investing in a fund will largely depend on the structure of the fund and its underlying fund documents. Certain notable risks/issues are considered below.

Making investments

The agreement between the fund and the investor in relation to subscription is typically enshrined in a subscription or capital call agreement. This tends to be a relatively short document, which needs to be read in conjunction with the constitutional documents underpinning the fund structure and the documents governing the service provider arrangements.

In many cases, it is the fund, acting through its directors, that will be authorized to make the calls on investors. Alternatively this role can be delegated to either the relevant investment manager or the administrator. For funds that are structured as Unit Trusts or CCFs, which are constituted by deed between the manager and the trustee/depository, it is usually the manager who is authorized to make the calls.

It is important to consider the full scope of fund documentation and the impact this may have on, for example, redemptions. In the context of a capital call facility (in the case of closed-ended funds or limited liquidity funds with a capital commitment structure), for example, it would also be important to understand: (i) the subscription process, including who can make calls on investors and when capital calls can be made; (ii) who determines the price at which units or shares are issued and by what means; (iii) what an investor can be asked to fund; (iv) the implications of an investor not meeting a capital call; and (v) the relevant account into which subscription funds must be paid. Any of these matters could result in risks for an investor, particularly if the obligations to fund are more onerous than expected or don’t align with any back-to-back funding arrangements an investor might have in place to meet such calls.

Managing investments

For Irish domiciled funds, the general rule is that any entity with discretionary asset management capacity, whether an investment manager or a delegate thereof such as a portfolio manager, must be approved in advance by the Central Bank of Ireland. Accordingly, issues may arise with regards to this approval process for any new entrants. There will also be ongoing compliance aspects to comply with once authorized. For example, an investment manager cleared to act for an Irish authorized fund should inform the Central Bank of Ireland in advance of any upcoming changes to its regulatory status, its name or registered address.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Irish selling restrictions
Generally, in Ireland, offering securities is either covered under the Central Bank's marketing regime, the UCITS regime or the AIF regime.

**Undertakings for Collective Investments in Transferable Securities (UCITS)**

UCITS, including those established in Ireland, have an EU passport which enables fund promoters to create a single product for marketing in all EU Member States and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another Member State must complete and submit to its home regulator a notification, including certain specified information, as well as copies of key investor documents. The notification procedure between competent authorities is transmitted on an electronic basis and contains information in relation to the marketing requirements of the host Member State, as well as the latest versions of the UCITS documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other Member State.

With the exception of certain classes of AIFs established in Guernsey, Jersey and the Isle of Man, a non-Irish AIF proposing to market their units in Ireland to retail investors (a RIAIF) must make an application to the Central Bank of Ireland for authorization, enclosing certain prescribed information, in order to ensure the protection of unitholders and (in the opinion of the Central Bank of Ireland) provide an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing RIAIFs.

**Alternative Investment Funds (AIFs)**

Under the AIFMD, marketing is defined as “a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.”

The passporting procedure under the AIFMD is similar to that which exists for UCITS funds in the EEA. An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access (subject to certain limited conditions) to marketing to professional investors across the EU under an EU passport or if it complies with national private placement regimes (where available). There is no need for additional authorization but there must be a notification letter for each EEA Member State in which the AIFM wishes to market its shares or units to professional investors.

For passporting purposes, an investor must meet the definition of professional client set out in the Markets in Financial Instruments Directive (2014/65/EU) (MiFID). According to MiFID, a professional client is a client who possesses the expertise, knowledge and experience to make its own investment decisions and properly assess the risks that it incurs. Furthermore, in the case of an AIF structured as a master/feeder, the master must be domiciled in the EEA in order to avail of the passport.

**Reverse solicitation and the definition of marketing**

Reverse solicitation or “passive marketing” is marketing that is not at the direct or indirect initiative of the fund manager. Applicable in the context of professional investors, it is a sensitive area in Ireland and across Europe generally. AIFMD generally continues to permit professional investors who approach an AIF based on their own initiative (i.e. a reverse solicitation). However, many commentators argue that reverse solicitation may constitute marketing under AIFMD and caution should be exercised if seeking to rely on the reverse solicitation argument.

Notwithstanding that the definition of marketing is very broad for the purposes of the AIFMD, no additional guidance on the concept is provided by the Central Bank of Ireland, leaving the definition open to interpretation. Most Member States have chosen not to provide guidance, but the UK Financial Conduct Authority (FCA) has done so, stating that marketing will occur when: “a person seeks to raise capital by making a unit or share of an AIF available for purchase by a potential investor. This includes situations which constitute a contractual offer that can be accepted by a potential investor in order to make the investment and form a binding contract, and situations which constitute an invitation to the investor to make an offer to subscribe for the investment” (FCA Handbook).

The AIFM would be well advised to consider at a minimum whether it had, for example, followed up with prospective investors following a marketing event or whether it had been in correspondence with prospective investors in a manner which could be construed as an “indirect” offering. Any AIFM seeking to rely on the reverse solicitation argument would also need to take care in preparing offering materials and marketing documentation, to include web-based platforms, to ensure that appropriate selling restrictions are specifically set out. Individual legal advice on a case-by-case and jurisdiction-by-jurisdiction basis should be sought, and it would be necessary to ensure that procedures and policies are put in place to clearly demonstrate that a particular EU investor invested in the fund on the basis of reverse solicitation.
If a manager is unwilling to rely on reverse solicitation, then the only alternative at present for such managers is to market in accordance with existing private placement regimes.

**Packaged Retail and Insurance-based Investment Products (PRIIPs)**

Packaged Retail and Insurance-based Investment Products are also common in the Irish market. Regulation (EU) No 1286/2014 on PRIIPS (the PRIIPS Regulation) introduced an obligation on all persons who manufacture, advise on or sell PRIIPs to retail investors (i.e. any person who does not fall within the definition of "professional client" under MiFID), to produce a pre-sale disclosure document known as a Key Information Document (the PRIIPS KID) to the retail investor in advance of them making their investment decision. Packaged investment products that are within the scope of the PRIIPS Regulation include life insurance investment products, investment funds, structured deposits and derivative instruments. Accordingly, RIAIFs, QIAIFs and UCITS are all capable of falling within the definition of a PRIIP for the purposes of the PRIIPS Regulation.

Similar to the UCITS KIID (Key Investor Information Document), the PRIIPs KID aims to explain the main features of risk, reward and costs to the retail investor in a concise document. Any PRIIPs KID must be updated annually, but may also need to be revised more frequently if changes are made to the produce which impact the information disclosed in the PRIIPs KID.

At present, UCITS can continue to provide a UCITS KIID to investors and will not have to provide a PRIIP KID until January 1, 2022.

**Are there any restrictions on managing a fund?**

A UCITS or AIF can appoint an external manager or be managed through its Board of Directors (where the legal form of the vehicle permits) and, in this case, the fund is referred to as an internally managed or self-managed fund. In contrast, those structured as a unit trust or as a CCF must always appoint a management company.

Where a fund does not appoint a management company, it is referred to as a self-managed investment company (SMIC). Where a UCITS is a SMIC, it is required to submit a detailed corporate governance and oversight document (known as a business plan) to the Central Bank of Ireland for review and comment before the UCITS can be authorized. In light of the additional corporate governance, oversight and time commitment obligations involved, the externally managed UCITS is a more popular model in Ireland. This structure has the advantage that the UCITS can relinquish compliance with certain obligations so that they rest with a management company instead.

Management of a fund is a regulated service. Both UCITS management companies and AIFMs incorporated in Ireland are authorized by the Central Bank. Irish authorized UCITS Management Companies and AIFMs can manage funds in other EU Member States on a cross-border passporting basis, subject to necessary notification requirements.

A fund manager may wish to establish its own management company or use a management company platform in cases where a management company is a requirement and the fund manager will be a signatory to the trust deed constituting the fund. A fund management company can also act as the central coordinator of service providers for the fund – i.e. the fund would delegate all management activities to the management company, which can then appoint, for example, a sub-investment manager, a fund administrator and/or different service providers.

Various restrictions arise on manager structuring/compensation and profit-sharing arrangements as a result of EU and Irish regulations and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and the scope and complexity of its activities. The rules affect, among other things, reporting, equity remuneration, deferred compensation arrangements and clawback.

AIFMs are also subject to regulation under the AIFMD and managers of UCITS are subject to certain requirements under the UCITS Regulations. Registration with the Central Bank of Ireland involves a significant authorization process. It is normal practice for the Central Bank of Ireland to engage with new applicants before the beginning of the process. An effective authorization process depends on the timeliness and quality of responses received from the applicant to the Central Bank of Ireland's comments. The completion of the application must be accompanied by (among other things) a detailed business plan, individual questionnaires, code of conduct and anti-money laundering protocols.

Funds established in Ireland as a UCITS or an AIF enjoy the benefit of the EU-wide passporting regime. A single management company (a so-called Super ManCo) can be authorized to manage both UCITS and AIFs and this can be used to obtain access to the passporting regimes for both UCITS and AIF products without the need to establish two separately regulated entities. The rules in relation to
establishment of Super ManCos has been updated by the Central Bank of Ireland, making this a favorable option.

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### Entering into derivatives contracts

**Are there any restrictions on entering into derivatives contracts?**

Regulation (EU) No 648/2012 on OTC (over-the-counter) derivatives, central counterparties and trade repositories, as amended by Regulation 2019/834, (EMIR) establishes certain regulatory requirements for counterparties to OTC derivatives contracts, including:

- a mandatory clearing obligation for certain classes of OTC derivatives;
- a margin posting obligation for OTC derivatives contracts not subject to clearing;
- daily valuation and other risk-mitigation techniques for OTC derivatives contracts not subject to clearing by an authorized or recognized central counterparty; and
- certain reporting and record-keeping requirements.

EMIR applies not only to Financial Counterparties (FCs) as regulated entities, but it also extends the supervisory remit of the Central Bank of Ireland to Non-Financial Counterparties (NFCs), the vast majority of which may not have not had any previous interaction with the Central Bank of Ireland.

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**What are common types of derivatives?**

In Ireland, derivative contracts are entered for a number of reasons, including hedging, arbitrage and speculation.

Derivatives may be traded OTC or on an organized exchange.

All of the main types of derivative contract are widely used in Ireland:

- futures;
- options (call options and put options); and
- contracts for difference (including swaps (such as interest rate or currency swaps) and forwards).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Ireland are:

- equities;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

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**Are there any other notable risks or issues around entering into derivatives contracts?**

Since the 2007-2008 global financial crisis, derivatives and over-the-counter derivatives have attracted significant regulatory attention.

The European Commission has sought in particular, to:
enhance transparency by requiring the provision of comprehensive information on OTC derivative position;
reduce counterparty risk by increasing the use of central counterparty clearing; and
improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

EMIR has recently been amended and the changes, known as EMIR Refit, entered into force in June 2019. The EMIR Refit aims to simplify the EMIR regime and reduce regulatory and administrative burdens and cost for smaller counterparties. For example, under the EMIR Refit Regulation, those categorized as small non-financial counterparties do not need to comply with reporting and clearing requirements from specified dates.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending to natural persons (other than in very limited circumstances; for example, if they are a professional client for the purposes of the Markets in Financial Instruments Directive (2014/65/EU)) is a regulated activity in Ireland. Lending to corporates is not regulated on a standalone basis; however, if the lending is accompanied by deposit taking or carrying on other banking business, this triggers a requirement to be regulated. If a loan to a corporate is originated by a regulated entity, the borrower may have the benefit of certain legislation such as the Lending to Small and Medium-Sized Enterprises Regulations 2015.

The Consumer Protection (Regulation of Credit Servicing) Act 2015 (as amended) provides that unregulated entities that hold loans or control the overall strategy or key decisions relating to such loans where those loans were advanced: (i) to natural persons; or (ii) to SMEs and were originated by regulated entities, must be regulated as credit servicing firms by the Central Bank of Ireland. These requirements apply, for example, if such loans are acquired by way of secondary purchase.

Lending to natural persons is (with limited exceptions) a regulated activity in Ireland. Consumer loans, including mortgage loans are subject to a range of regulatory requirements, including around how those loans are marketed, originated and sold, how the lender administers the loans on an ongoing basis and how borrowers who fall behind on their repayments are dealt with by the relevant lender. The Central Bank of Ireland, in recent years, has also imposed certain rules providing for financial limitations and other conditionality relating to mortgage lending in Ireland.

Borrowing

Borrowing is not a regulated activity in Ireland. However, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities in which case they will benefit from certain regulatory protections.

What are common lending structures?

Lending in Ireland can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or on a syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are
more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loan Market Association documents are widely used in Ireland and are adopted for Irish law.

Loans will be structured to achieve specific objectives, e.g. term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

**LOAN SECURITY**

A loan can be either secured, unsecured or guaranteed. For more information, see *Giving and Taking of Guarantees and Security*.

**LOAN TERM**

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan term is important as a longer term loan might incur more interest. Ensure that a guaranteed loan has an end date; for example, an overdraft account.

**LOAN COMMITMENT**

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

**LOAN REPAYMENT**

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

*What are the differences between lending to institutional / professional or other borrowers?*

Please see above in relation to the differences in lending to corporates and to natural persons.

*Do the laws recognize the principles of agency and trusts?*

Yes, both principles are recognized as a matter of Irish law. For example, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lender or secured parties.
Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. For example, a contractual provision that has the effect of placing an increased obligation on a party as a result of a breach of contract needs to be carefully examined to establish if it amounts to a genuine pre-estimate of probable loss. If not, it is likely to be considered to be an unenforceable penalty.

Examinership

Examinership is a corporate rescue procedure provided for under the Companies Act 2014. The appointment of an examiner will restrain any enforcement action (including the appointment of a receiver) against a company for the duration of the examinership (typically 70 days, but extendable to 100 days) during which the examiner will attempt to put in place a scheme of arrangement with the company's creditors. During the period of examinership, a lender cannot enforce its security or seek to appoint a receiver over the company's assets without the examiner's consent.

Specific types of lending

Depending on the borrower in question – and particularly where consumers and SMEs are involved, lenders may have enhanced obligations towards borrowers; for example, when advertising products, communicating with borrowers and undertaking arrears handling and enforcement procedures.

Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD is an EU framework which came into effect on 15 July 2015. It acts as the central resolution authority with the EU Banking Union and outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities. Article 55 of the BRRD gives authorities the power to bail in obligations of failed EEA financial institutions and also to postpone the enforcement of early termination rights against the affected institution. Bail in describes a variety of write-down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Irish or other EEA law contracts, such powers override contractual terms. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Capacity

The constitutional documents of a corporate borrower should be examined to ensure that it has the power into the guarantee or security.

It should be noted that the constitution of an LTD company does not contain an objects clause and, subject to other applicable laws, LTDs have the same capacity as a natural person.

Corporate benefit

Under Irish law, directors have a general duty to promote the success of the company for the benefit of its members as whole; as such,
they will need to be able to show that adequate corporate benefit is derived from the company giving a guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The prudent approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

Financial Assistance

Under Irish law (Section 82 of the Companies Act 2014), it is not lawful for a company to provide financial assistance (this definition is broadly drafted and can be by way of a loan, security, guarantee or otherwise) for the purposes of the acquisition made or to be made by any person of shares in that company, or where the company is a subsidiary, in its holding company, unless one of the statutory exemptions apply or the company has availed of the “summary approval procedure” (a statutory procedure provided for in the Companies Act 2014) The rationale for the prohibition is the preservation of the company's capital and shareholder and creditor protection.

Where the financial assistance is being given by a company that is a private company, it can avail of the ‘summary approval procedure’, which validates the giving of financial assistance by the company. This requires (amongst other things) that the directors of the company make a declaration that in their opinion the company will be able to pay its debts and liabilities in full as they fall due in the 12 months following the giving of the financial assistance. If a company enters into a transaction in contravention of Section 82, the transaction will be voidable at the instance of the company against any person (whether a party to the transaction or not) who “had notice of the facts” that constitute such contravention. If a company contravenes Section 82, the company and any officer (e.g. directors, company secretary, etc.) of the company who is in default shall be guilty of an offence under the Companies Act 2014.

Unfair Preference

Any payment or other transfer of property (including security) by a company within six months of its insolvent winding up in favor of any creditor with a view to giving such a creditor a preference over other creditors, shall be deemed an unfair preference. The six-month period extends to two years where such creditor is a “connected person.” If a transaction is held to be an unfair preference, a liquidator or receiver of the company may recover the money paid or property transferred to the creditor, or may have the security set aside.

Improper Transfer

Where a company is being wound up, a liquidator or creditor of or contributory to such company can apply to court to have a disposition (which includes security) set aside, and for the return of the assets the subject of the disposal, where the disposition had the effect of perpetrating a fraud on the company, its creditors or its members. There is no time limit within which an improper transfer can be challenged.

Invalid floating charge

A floating charge created within the period of 12 months before the commencement of the winding-up of a company will be invalid except to the extent of monies actually advanced or paid, or the actual price or value of goods or services sold or supplied, to the company at the time of or subsequent to the creation of, and in consideration for the charge, or to interest on that amount at the appropriate rate or unless the company was solvent immediately after the creation of the charge. The 12 month period is extended to 2 years where the floating charge is created in favour of a ‘connected person’.

Recharacterization of fixed charges

Fixed charges (e.g. on bank accounts) can be re-characterized as floating charges if the requisite prohibition on dealing with the account and the monies therein is not adequately provided for in the relevant security document notice to the account bank.

What are common types of guarantees and security?

Guarantees

Contracts of suretyship may be divided into two broad categories: guarantees and indemnities. The key distinction between a guarantee and an indemnity is that under a contract of guarantee, the guarantor assumes an obligation to answer for the debt of another (i.e. a
secondary obligation contingent on the obligation of the principal to the beneficiary of the guarantee). Accordingly, a guarantor will only be liable if the principal debtor is liable. However, in the case of an indemnity, the party providing the indemnity has a primary obligation to make good the loss suffered by the beneficiary. The obligation of the party providing the indemnity does not depend on the existence of an underlying obligation. Whether a surety is liable where the main contract is void because of, for example, the principal's incapacity, depends on whether the contract is a guarantee or an indemnity. Guarantees incorporating indemnities are common on Irish financing transactions.

It should be noted that while an Irish regulated fund can provide guarantees or security in respect of any 100% owned subsidiary, it is however restricted from acting as a guarantor on behalf of third parties. The term "guarantor" for this purpose is not defined and so it potentially extends to all forms of credit support. In addition, this prohibition extends to one sub-fund providing security for the obligations of another sub-fund of the same ICAV.

Common forms of security

There are a number of different types of security interest that can be created under Irish law, including charges, mortgages and pledges.

Different types of security are used to secure different types of assets.

Under Irish law it is possible to grant security over all of the assets of an Irish company or over individual assets. Granting security over all of a company's assets will tend to be achieved by way of an "all assets" debenture which will typically include:

- a charge over real estate;
- a fixed charge over assets which are identifiable and can be controlled by the creditors (such as equipment);
- a floating charge over fluctuating and less identifiable assets (such as stock); and
- an assignment by way of charge over receivables and contracts.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing, signed by the guarantor and be provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. The relevant underlying obligations will usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Also, it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary (e.g. between a borrower and a lender). As a result, guarantees are usually executed as deeds to avoid any argument that there was a lack of consideration. Deeds have particular execution requirements under Irish law which need to be observed.

A guarantee is a secondary obligation dependent on the existence of the borrower's liability to the lender. As a result, as mentioned above, guarantees will often also include an indemnity, imposing a primary obligation on the guarantor to repay the relevant debt, as well as also guaranteeing repayment of the debt to the lender.

Irish law takes a protective approach towards guarantors given that the nature of a guarantee involves assuming the obligations of a third party. This means that there are various factors that lead to a guarantee being deemed as discharged, such as a material variation of the underlying agreement or a misrepresentation by the borrower. A guarantee may also be set aside on the basis that it was procured by duress or undue influence (by either a borrower or a lender). A party being provided with a guarantee should be alert to this issue and take steps to avoid such claims by, for example, requiring the guarantor to take independent legal advice.

In terms of regulatory compliance, lenders should note that prescribed warnings must be included in guarantees to which the Central Bank of Ireland's Consumer Protection Code 2012 and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium-Sized Enterprises) Regulations 2015 (the SME Regulations) apply.
In addition, the SME Regulations, where applicable, impose certain obligations on lenders in their dealings with guarantors. A guarantee may also be limited or vitiated on certain statutory grounds, including under the Consumer Credit Act 1995 and the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995.

**Giving or taking security**

Although only a limited number of assets require a security document to be executed as a deed (e.g. real estate), it is standard practice in Ireland for security documents to be executed as deeds. The formalities for the execution of deeds are set out in legislation (and in the relevant entity's constitutional documents).

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the security and notice being given to third parties. Details of mortgages or charges created by a company or an ICAV must be delivered to the Companies Registration Office or the Central Bank of Ireland (as applicable) within 21 days either of the creation of the charge. Failure to register the charge within 21 days has the effect of rendering the charge void against a liquidator of the company/ICAV and any creditor of the company/ICAV. Priority will be determined by the date and time of receipt by the Companies Registration Office or the Central Bank of Ireland of a fully filed charge submission. The date of creation of the deed of charge does not determine its priority. Certain categories of assets, including cash and shares, are carved out from the foregoing registration requirements.

**Notarization**

There are no notarization requirements for security documents or guarantees under Irish law.

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**Financial regulation**

**Law and regulation**

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

The Central Bank Acts 1942-2019

**Consumer Credit**

Consumer Credit Act, 1995

European Communities (Consumer Credit Agreements) Regulations, 2010

Consumer Protection Act 2007

European Communities (Unfair Terms in Consumer Contracts) Regulations, 1995

European Communities (Distance Marketing of Consumer Financial Services) Regulations, 2004

EU (Consumer Mortgage Credit Agreements) Regulations 2016

Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium-Sized Enterprises) Regulations 2015

Consumer Protection Code 2012

Code of Conduct on Mortgage Arrears

Consumer Protection (Regulation of Credit Servicing Firms) Act 2015
Corporations

Companies Act 2014 (as amended)

Funds and Platforms

European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011

EU (Key Information Document for Packaged Retail and Insurance-Based Investment Products (PRIIPS)) Regulations 2017

EU (Money Market Funds) Regulations 2018

Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2019

EU (Alternative Investment Fund Managers) Regulations 2013

Irish Collective Asset-Management Vehicle Act 2015

Taxation

Taxes Consolidation Act, 1997

Other key market legislation

Credit Reporting Act 2013

European Communities (Electronic Money) Regulations 2011

EU (Payments Services) Regulations 2018

EU (Markets In Financial Instruments) Regulations 2017

EU (Market Abuse) Regulations 2016

European Market Infrastructure Regulation (EMIR) Regulation 2012

EMIR Refit Regulation 2019


EU Prospectus (Amendment) Regulations 2019

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Regulatory authorization

Who are the regulators?

The Central Bank of Ireland is the body responsible for prudential regulation and conduct of business of financial services firms operating in Ireland. It is also responsible for enforcing Ireland’s market abuse and listing regimes.

Since November 2014, following the implementation of the EU single supervisory mechanism, credit institutions have been subject to EU-wide regulation. This grants the European Central Bank (the ECB) powers in relation to the prudential supervision of credit institutions. There are two categories of “credit institution” in Ireland – those which are designated by the ECB as “significant” and those designated as “less significant”. Where a credit institution is designated as “significant”, it is supervised directly by the ECB, whereas credit institutions designated as “less significant” are subject to direct supervision by the Central Bank of Ireland, and to indirect supervision by the ECB.

Financial institutions may also be subject to the supervision of other regulatory bodies or agencies, such as the Data Protection Commission. In addition, certain agencies have statutory responsibility for investigating and/or enforcing financial services law.
example, the Financial Services and Pensions Ombudsman is empowered to investigate and resolve disputes between consumers and financial institutions. The Competition and Consumer Protection Commission has statutory responsibility for enforcing competition and consumer protection law.

**What are the authorization requirements and process?**

Depending on the nature of its activities or the relevant sector within which it intends to operate, a firm may need to apply to the Central Bank of Ireland for authorization before commencing activities. The form and content of the application will vary depending upon the nature of the authorization being sought; however, it will usually involve the submission of an application form, along with supporting documentation, to the Central Bank of Ireland.

Upon receipt of the required documentation, the Central Bank of Ireland will complete an assessment of the application and may issue detailed comments and/or seek additional information, in which case the applicant will be provided with the opportunity to address the comments and requests issued by the Central Bank of Ireland in a revised application submission(s). The Central Bank of Ireland will then notify the applicant of its decision in respect of the application submission.

The time taken to assess the applicant's submission depends on the nature of the application and/or authorization sought.

There are no fees for applications; however, the Central Bank of Ireland imposes levies after authorization.

Authorized firms are listed on the CBI Register.

The Central Bank of Ireland will also approve key individuals (e.g. senior management in their roles).

**What are the main ongoing compliance requirements?**

The ongoing compliance obligations imposed on a regulated entity will vary depending on the industry within which it operates and the type of authorization obtained.

The Central Bank of Ireland monitors ongoing compliance with prudential standards, primarily through examining returns (weekly, monthly and annual), financial statements and annual reports, conducting regular review meetings and on-site inspections.

The Central Bank of Ireland has published fitness and probity standards for persons performing particular functions within a regulated entity. These standards in general require that such a person is: (i) competent and capable; (ii) honest, ethical and acts with integrity; and (iii) financially sound. In the case of credit institutions considered to be “significant” for the purposes of the EU single supervisory mechanism and credit institutions applying for authorizations, fitness and probity assessments are carried out by the European Central Bank.

Failure to comply with these regulatory requirements can result in sanctions for regulated firms and individuals performing prescribed functions within those firms, and loss of regulated status.

**What are the penalties for failure to be authorized?**

Any person who undertakes a regulated activity without being authorized or exempt commits a criminal offence and is liable to financial sanctions. Depending on the nature of the offence, the Central Bank of Ireland can issue a caution or reprimand, a disqualification of an individual from managing a regulated firm, a prohibition of an individual from working in a regulated firm and fines ranging from up to EUR1 million (for individuals) and up to EUR10 million or 10% of the firm's turnover (for corporations).

**Regulated activities**
What finance and investment activities require authorization?

A person must not carry on a regulated activity in Ireland unless authorized or exempt.

Generally speaking, the Central Bank of Ireland regulates the activities of:

- credit institutions, credit servicing firms, investment firms, funds, fund service providers;
- insurance and reinsurance companies;
- moneylenders, mortgage and credit brokers and intermediaries;
- bureaux de change, electronic money institutions, money transmission businesses, payment institutions; and
- credit unions, among others.

One point of note is that commercial lending is not of itself a regulated activity in Ireland (unless the lender is engaged in deposit-taking or carrying on other banking business); however, certain regulatory reporting requirements may apply to such lenders.

Are there any possible exemptions?

There are certain exceptions and exemptions to the general requirements to be regulated. Therefore, the relevant legislation, rules and guidance should be examined to ascertain whether any exception/exemption applies.

In addition, a firm that is authorized to provide certain services by the regulatory authority of another country in the European Economic Area may also be permitted to provide financial products and services into Ireland without the need to apply to the Central Bank of Ireland for authorization through the free provision of services on a cross-border basis, i.e. by "passporting" into Ireland, from its home Member State.

Do any exchange controls or other restrictions on payments apply?

Ireland does not operate any exchange controls.

The Minister of Finance has the power to restrict financial transfers between Ireland and other countries provided such restrictions comply with EU laws. Ireland is subject to, and complies with, EU Council Regulations relating to financial sanctions, also known as "restrictive measures." Once a person or entity has been sanctioned under EU financial sanctions, there is a legal obligation not to transfer funds or make funds or economic resources available, directly or indirectly, to that person or entity.

Payments services, e-money services and money transmission services are all regulated activities in Ireland and must only be undertaken by an authorized payment service provider, e-money institution or money transmission business, as the case may be.

Anti-money laundering and tax considerations may also need to be taken into account.

What are the rules around financial promotions?

There is no cross-sectoral financial promotions regime in effect in Ireland.

There are, however, certain sector-specific rules (both domestic and EU) in respect to the promotion of specific services and products, including requirements in relation to advertisements and incentives. These arise, for example, under the Prospectus Regulation, the MiFID Regulations, the Insurance Distribution Regulations and the Consumer Protection Code.
**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

The most common types of legal entities/structures used to undertake financial or investment activity in Ireland are companies, limited partnerships and regulated funds.

**COMPANIES**

The most common types of company used to undertake financial or investment activity in Ireland are private limited companies (either private companies limited by shares (LTD) or designated activity companies limited by shares (DACs)), companies limited by guarantee, unlimited companies and public companies. These each have separate legal personality and apart from unlimited companies, limit the liability of their members.

**LIMITED PARTNERSHIPS**

Limited partnerships (established in Ireland under the Limited Partnerships Act 1907) are also frequently used; these are unregulated, tax transparent and unlike companies, do not have separate legal personality.

**FUNDS**

Ireland is regarded as a key location by the world's investment funds industry and Ireland as a domicile provides for a number of different regulated fund vehicles. These include Irish collective asset management vehicles (ICAVs), investment limited partnerships, unit trusts, investment companies and common contractual funds. The ICAV is a relatively new corporate vehicle, governed by the Irish Collective Asset-Management Vehicles Act 2015, which has proven very popular as an investment vehicle. It is a suitable fund vehicle for both UCITS and AIFs and it is not affected by amendments to the company law that are more generally targeted at trading companies.

Please see further at Topic 7 below in relation to **Establishing and Investing in Debt and Hedge Funds**.

Some activities require a particular type of legal entity to be used. For example, offering debt securities to the public cannot be done by a private company limited by shares.

**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes. A foreign company seeking to conduct lending or investment business in Ireland can do so through a branch or establishment. Any company which is incorporated outside Ireland and establishes a branch in Ireland must be registered within one month of its establishment with the Companies Registration Office under the Companies Act 2014 and must comply with certain ongoing disclosure and other requirements prescribed by that Act. There are some differences between the requirements imposed on a company from a Member State of the European Economic Area and companies from third countries.

Whether or not a foreign company can be deemed to have established a branch in Ireland is dependent on a number of factors, including whether that company has an independent Irish management structure, a reasonable degree of financial independence and the appearance of permanency.

**FinTech**

**FinTech products and uses**

**What are the most common technology products and FinTech applications used or being**
developed in the finance and investment marketplace?

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P)-type structures, often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds, as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt, this will typically result in the platform being treated as a securitization for the purposes of the EU Securitization Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features, such as; its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever
transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (e.g. in the case of cryptocurrencies such as bitcoin) or providing an indisputable record; for example, relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (permissionless or unpermissioned) or structured within a private group (permissioned).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an address). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so-called smart contracts. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so-called Oracles. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of the transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is
illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**ARTIFICIAL INTELLIGENCE AND ROBO ADVISORY SYSTEMS**

Automated financial advice tools, also known as robo advisors are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**DATA ANALYSIS AND CLOUD COMPUTING**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running fintech businesses and the technology has had a significant impact in recent years.

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*Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?*

The Central Bank of Ireland is the conduct regulator providing financial products in both retail and wholesale markets.

**GENERAL**

A person must not carry on a regulated activity in Ireland unless authorized or exempt. A financial activity requires regulatory authorization when it involves the provision of services or undertaking of activities constituting a regulated activity (as defined in legislation). Where fintech businesses do provide a regulated activity and which cannot avail of an exemption – they will fall within the
existing body of financial regulation and so require prior authorization from the Central Bank of Ireland to conduct business.

Where a fintech business is authorized the firms will be subject to Irish legislation and various ongoing Central Bank of Ireland requirements, but fintech companies authorized by the Central Bank of Ireland can benefit from regulatory passporting across the EU. Payment institutions, electronic money institutions (EMIs), investment companies, money transmission businesses and payment initiation and account information service providers are examples of business models which may require authorization, as will certain crowdfunding platforms when the EU Crowdfunding Regulation comes into force.

INNOVATION HUB

The Central Bank of Ireland launched its Innovation Hub in April 2018 to enable open and active engagement with all firms innovating in financial services. The Innovation Hub provides firms with a direct and dedicated point of contact at the Central Bank of Ireland as a means to pose questions on the authorizations process, the regulatory framework or engage in a discussion on their product or service outside of more formal regulatory process.

CROWDFUNDING AND PEER-TO PEER LENDERS

Crowdfunding is a relatively new and growing industry and is working for businesses in Ireland by providing peer-to-peer lending. The speed at which funds can be raised through platforms such as LinkedFinance, Flender, Fund:it and Kickstarter makes this a particularly attractive option for small businesses. Currently, the lending model is more prevalent in Ireland (as opposed to equity investment) but Spark Crowd Funding launched Ireland's first equity crowdfunding platform and the company seeking to raise new money to finance its growth plans offers a fixed number of shares to subscribers i.e. crowd in return for finance.

Ireland does not currently have a bespoke regulatory regime for crowdfunding. However, the EU Commission has published a proposal for an EU Crowdfunding Regulation which would include a comprehensive authorization and passporting regime for crowdfunding platforms across Europe. The Central Bank of Ireland also issued a Feedback Paper on the Regulation of Crowdfunding in Ireland, which indicated that "proportionate" regulation was favored generally.

Plans by the Department of Finance to regulate crowdfunding could further develop the debt funding options for fintech businesses.

CRYPTOCURRENCIES

Cryptocurrencies and cryptoassets are not subject to specific regulation in Ireland, and the Central Bank of Ireland confirmed that such virtual currencies do not have legal tender status in Ireland. While there is no specific regulation, it should be noted that cryptocurrencies or cryptoassets may be subject to the existing regulatory frameworks that are in place.

The regulation of cryptoassets is currently being considered at an EU level and Ireland would likely follow any proposed approach to ensure the implementation of a uniform regulatory regime.

ELECTRONIC MONEY

Electronic money (E-Money) is a relatively recent kind of payment instrument. Instead of using a debit card (which requires a bank account) or a credit card (which requires a contract agreement) the customer has purchased a non-cash means of payment. This may be in the form of value stored on a technical device such as a chip card or a computer and can be best described as a digital form of cash since it has many of the characteristics of cash. E-money can therefore be defined as monetary value as represented by a claim on the issuer, which is electronically stored, issued on receipt of funds for the purposes of making payment transactions and accepted as means of payment by a natural or legal person other than the issuer.

An E-Money institution is an undertaking that has been authorized to issue E-Money in accordance with the European Communities (Electronic Money) Regulations 2011, as amended (the EMR). An applicant seeking authorization must satisfy the Central Bank of Ireland that it can meet the authorization standards set out in the EMR. In complying with these standards, the Central Bank of Ireland, as gatekeeper, adopts a robust and structured process and so only applicants that can demonstrate compliance with these authorization requirements are authorized. The Central Bank of Ireland provides guidance on its website for to firms considering applying for authorization as an electronic money institution to provide clarity with regard to the process, its requirements and timelines.

REGULATION OF PAYMENT SERVICES

The Payment Services Regulations 2018 enhance regulation in the area of fintech by: (i) increasing reporting obligations applicable to providers offering payment services; (ii) applying new authorization requirements for providers offering payment services (payment
initiation and account information service providers now require authorization); and (iii) requiring that all remote and online payment transactions meet strong customer authentication requirements.

The issue of strong customer authentication is subject to regulatory technical standards published by the European Banking Authority.

**APPLICATION OF DATA PROTECTION AND CONSUMER LAWS**

The Data Protection Acts 1988-2018 (the DPA) regulate the processing of personal data within Ireland. The DPA gives further effect to the European General Data Protection Regulation (EU) 2016/679 (the GDPR), which came into effect on May 25, 2018. As a European Regulation, GDPR has direct effect in Irish law and automatically applies in Ireland. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the DPA and have certain notification and compliance obligations.

The GDPR is more prescriptive and restrictive compared to the principles-based DPA, including mandatory notifications where a breach occurs and provide for severe monetary sanctions for breach. GDPR sets the key principles, rights and obligations for most processing of personal data.

The ePrivacy Regulations (SI 336/2011) regulate direct marketing by electronic means. The general rule is that the affirmative consent of the recipient is required (such as by specifically opting-in). Even where the direct marketer has the consent of the data subject to use their personal data for marketing, that consent may be withdrawn by the data subject. Article 21 of GDPR provides that a data subject has the right to object at any time to the use of their data for such marketing.

**MONEY LAUNDERING REGULATIONS**

The Irish legislation in this area is the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 as amended by Part 2 of the Criminal Justice Act 2013 and the Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Act 2018 (the MLA). The MLA give the Central Bank of Ireland responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment. Generally, where a firm is authorized and supervised by the Central Bank of Ireland it will also be authorized and supervised by the Central Bank of Ireland for complying with anti-money laundering requirements. The Central Bank of Ireland has published guidelines setting out its expectations for credit and financial institutions in relation to compliance with their obligations with regards to anti-money laundering and countering the financing of terrorism.

In addition, the General Scheme of the Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Bill 2019 will transpose the Fifth EU Anti Money Laundering Directive (EU) 2018/843 into Irish law and will impose obligations on (certain types of) exchanges and wallet providers and will bring the following firms within the scope of the MLA:

- cryptoasset exchange providers (including Cryptoasset Automated Teller Machine (ATM), Peer to Peer Providers, Issuing new cryptoassets, e.g. Initial Coin Offering (ICO) or Initial Exchange Offerings); and
- custodian wallet providers.

**What type of funding arrangements and incentives are available to FinTech businesses?**

Most Irish fintech businesses are raising funding through traditional funding mechanisms such as seed investment, venture funding, debt and government-supported funding.

DLA Piper Ireland has excellent relationships with all stakeholders involved in these funding arrangements and is happy to make introductions for clients as required.

**EARLY STAGE**

**FINTECH IN IRELAND**

A number of key organizations, incubators and other support mechanisms have emerged in Ireland to further develop the growing fintech sector.

1. Industry Organizations
Fintech industry organizations in Ireland include:

- The FinTech and Payments Association of Ireland – the main trade association representing fintech and payments businesses in Ireland.
- FinTech Ireland – an independent, nonprofit organization which regularly collaborates with other organizations internationally to run events in Ireland.
- Blockchain Ireland – a combined effort of the Irish government and Irish-based companies, led by the Industrial Development Authority Blockchain Expert Group to promote and share information on blockchain in Ireland.

  a. Incubators and accelerators

  • Incubators

  Incubators cater to new companies specifically, nurturing the growth of a new business, as the name suggests. An incubator typically offers shared office spaces, networking and mentoring opportunities and perhaps some seed capital. Examples of such incubators include Dogpatch Labs (which operates a co-working space for scaling technology start-ups) and the Digital Hub, where hundreds of companies have progressed through its enterprise cluster and gone on to create thousands of jobs in Ireland’s digital economy.

  • Accelerators

  There are various accelerators in the Irish market which offer support, facilities and funding for fintech startups, often in return for an equity stake. For example, the Citi Accelerator Hub is a co-working space for fintech startups located in Citi’s offices in the IFSC in Dublin and offers participating startups access to Citi’s mentoring network for advice and support, as well as industry meet-ups and networking events. Another example is the MasterCard Labs StartPath program which provides a four-month program and office space in MasterCard’s Dublin office, which is its global technology HQ.

SEED INVESTMENT

Initial investment in fintech businesses may be provided by family and friends of the founders and other investors, in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The Irish Venture Capital Association (IVCA) reported that there was a 55% year-on-year increase in seed funding in Ireland in 2019, from EUR49 million in 2018 to EUR76 million in 2019.

VENTURE CAPITAL

Venture capital is a type of equity investment provided by full-time, professional firms (venture capitalists) who invest with management in ambitious, fast-growing companies with the potential to develop into significant businesses. Venture capital firms and private equity investors continue to focus on high potential fintech businesses. According to the IVCA, fintech companies raised 9% of the total venture capital investment in Irish small and medium-sized businesses in 2019.

VENTURE DEBT

An additional funding option is venture debt, which is offered by banks such as the European Investment Bank and offers long-term venture debt products for fast growing companies. The financing structure of venture debt includes bullet repayments and remuneration linked to equity risk, and compliments existing venture capital financing. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

SENIOR BANK DEBT

Once a fintech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. Bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CONVERTIBLE LOAN NOTES

A popular funding tool for fast-growing fintech businesses is to issue convertible loan notes, which are essentially a hybrid between debt
and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

ONLINE FINANCING

In addition to traditional lending from financial institutions for small and medium-sized businesses, there are also online financing platforms available for fintech businesses in Ireland.

CROWDFUNDING

Crowdfunding is the financing of a new project by raising many small amounts of money from a large number of people and often involves the financing being provided in exchange for an equity investment in the relevant company. As discussed above, Ireland does not currently have a bespoke regulatory regime for crowdfunding. The Irish government's Ireland for Finance 2025 Strategy Paper in March 2019 included a proposal to regulate crowdfunding in Ireland and enact a domestic regulatory regime, in parallel with European regulation, to ensure sufficient consumer protection for unsophisticated investors and to facilitate the growth of crowdfunding as an alternative source of finance for Irish small and medium-sized enterprises.

PEER-TO-PEER (P2P) LENDING

Another alternative form of funding is by way of P2P lending platforms such as Flendr and Linked Finance. P2P lending involves a person or party lending money to a business rather than going through a traditional bank. Typically, P2P lenders earn interest in addition to capital repayments in exchange for their funding as opposed to any equity investment in the relevant company. Ireland does not currently have a bespoke regulatory regime for P2P lending.

GOVERNMENT-SUPPORTED FUNDING

The Irish government, through its various arms, offers funding arrangements and incentives to fintech businesses doing business in Ireland. We have outlined some of these arrangements and incentives below.

ENTERPRISE IRELAND (EI)

EI is a state agency responsible for the development and growth of Irish companies in world markets. EI offers a number of supports to fintech businesses including:

(a) Competitive Start Fund – this fund is open to early stage companies in fintech and offers EUR50,000 equity investment designed to accelerate the development of high potential startup companies by supporting them to achieve commercial and technical milestones such as evaluating international market opportunities or building a prototype; and

• Innovative High Potential Start-up Fund (HPSU) – this fund allows EI to offer equity investment to HPSU clients, on a co-funded basis to support the implementation of a company's business plans.

INDUSTRIAL DEVELOPMENT AUTHORITY (IDA)

The IDA is responsible for attracting multinational investment into Ireland, its primary goal being to create new employment. The IDA provides logistical support and granting assistance to its client companies. Grants are negotiated on a project-by-project basis (and are usually subject to job creation in Ireland) and are subject to limits and EU state aid rates. IDA fintech clients include Stripe, First Data, Rubicoin and Future Finance.

• Ireland Strategic Investment Fund (ISIF)

The ISIF, managed and controlled by the National Treasury Management Agency, is an EUR8 billion sovereign development fund with a statutory mandate to invest on a commercial basis in a manner designed to support economic activity and employment in Ireland. The ISIF offers companies “permanent” capital that can work to a longer-term horizon than most participants in the market. The ISIF has invested in fintech companies such as Silicon Valley Bank and Polaris Partners.

Other government-led initiatives worth mentioning include:

• Disruptive Technologies Innovation Fund – this fund provides EUR500 million for projects which include the use of disruptive technologies that will significantly alter the way we work and live, involve collaboration, innovation and/or be disruptive in its impact on
one of the sectors in the competitively-funded Research Priority Areas designated by the Irish government (one of which includes Business Services and Processes).

- Startup refunds for Entrepreneurs – offers individuals the ability to obtain up to a 41% refund for capital they invest in their own startup business.

- Employment and Investment Incentive (EII) – offers individuals the ability to claim up to 40% tax relief on investments they make in other companies.

**CAPITAL MARKETS FUNDING**

Raising finance by way of an Initial Public Offering (IPO) is a popular funding arrangement for fintech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as EuroNext Dublin.

**TAX INCENTIVES AND RELIEFS**

Ireland has for many years used tax incentives as a tool to attract foreign direct investment. In addition to the 12.5% rate of corporation tax on trading profits, the other key tax benefits available to fintech businesses investing in Ireland include:

- tax relief on the acquisition costs of IP and other intangibles;
- a generous R&D tax credit system giving an effective tax deduction of 37.5% for qualifying expenditure;
- stamp duty exemption available on the transfer of a wide range of IP;
- no Capital Gains Tax on gains from the sale of certain shares and reduced tax on foreign dividends;
- key employee reward mechanism;
- Ireland's Extensive Double Taxation Treaty Network;
- the first OECD compliant patent box regime (the Knowledge Development Box) with 6.25% effective tax rate on profits arising from certain types of IP; and
- extensive domestic exemptions from withholding tax on interest and dividend payments.

*Last modified 16 Jul 2020*

**Portfolio sales**

**Loan transfers and portfolio sales**

**What are common ways of buying and selling loans?**

Buying and selling loans is quite common in Ireland. A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

There are a number of legal methods to transfer loans and any associated underlying security. The most common ways of selling loans are:

- **Assignment** – An assignment is only effective to transfer rights under a contract and not the obligations and liabilities (see further discussion on novation below). Subject to any contractual restrictions, assignment can be done without the consent of the underlying debtor. An assignment can be effected as either an equitable assignment or a legal assignment depending on whether certain statutory requirements have been satisfied, namely that the assignment must be: (i) in writing under the hand of the assignor; (ii) of the whole of the debt; and (iii) absolute (that is, unconditional) and not by way of charge.

If the assignment does not fulfil all these requirements, it will likely take effect as an equitable assignment so that any subsequent assignment effected by the seller which is fully compliant with the Supreme Court of Judicature Act 1877 requirements will take priority, if notified to the debtor before the date on which the original assignment is notified to the debtor.
Novation – A novation is a full legal transfer of the party’s rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

Novation is often not practical when seeking to transfer a large pool of loans and associated security, given the need for obligor consent. The form and content of the transfer documentation will depend on the nature of the underlying assets being sold.

Other methods which are less frequently used to buy and sell interests in loans include a declaration of trust over the proceeds of the receivables or a sub-participation (this being a transfer of the economic interest in a loan without changing the legal relationship between the existing parties).

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s/buyer’s legal advisors.

Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms;
- **consent** – whether a transfer requires the consent or notification of any other parties. Under the Central Bank’s Code of Conduct on the Transfer of Mortgages, a loan secured by a mortgage of residential property may not be transferred without the written consent of the underlying debtor. However, the relevant consent is often obtained under the mortgage origination documentation (which should be checked to confirm on a case-by-case basis);
- **notice of assignment** – in order for a legal assignment to be effective, a notice of assignment must be given under the Supreme Court of Judicature Act 1877 to the underlying debtor, notifying them that the loan has been assigned. The notice serves to inform the debtor to whom he must repay the loan;
- **perfection formalities** – whether the underlying security is preserved in favor of the new lender and whether any perfection formality is needed for the transfer to be enforceable (in addition to the service of a notice of assignment under the Supreme Court of Judicature Act 1877);
- **regulatory requirements** – whether the assignee is required to be registered as a credit servicing firm pursuant to the Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 (as amended); and
- **tax** – whether taxes apply. A transfer of a loan by way of novation should not give rise to stamp duty. However, in limited circumstances, stamp duty might arise on the acquisition of a loan by way of assignment.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?
Ownership

The ownership of energy and infrastructure assets in Ireland varies according to the asset class. These asset classes can be broken down into the following key areas:

- economic infrastructure (energy, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health, justice/prisons and social housing).

Many of Ireland's infrastructure assets are publicly owned, but the provision of energy and telecommunication services that were once provided by state-owned monopolies now operate in a regulated competitive market that provides customers with a wide array of advanced services.

Ireland 2040 is the Irish state's infrastructure investment plan which guides public and private investment and has as its aim to accomplish ten strategic outcomes. An accompanying National Development Plan sets out EUR116 billion worth of planned projects over the next ten years, including investment in transport, housing, hospitals and schools. It anticipates EUR91 billion in funding directly from the exchequer, as well as nearly EUR25 billion in investment from state-owned commercial companies.

Key sectors are considered below.

ELECTRICITY SUPPLY

The Irish electricity market has been going through a process of liberalization since 1998. Before this, the Electricity Supply Board (the ESB) operated as a state-owned monopoly. The liberalization has happened in phases with sectors of the market being progressively opened for competition, with the market wholly open to competition since 2004.

The Commission for Regulation of Utilities (the CRU) is the principal body with responsibility for regulation of the energy sector in the Republic of Ireland. The functions and duties of the CRU have been altered and expanded by legislation transposing EU directives into Irish law.

There are now several electricity suppliers licensed by the CRU to supply electricity to residential and business customers.

The ESB owns the transmission and distribution networks in the Republic of Ireland and EirGrid plc (as transmission system operator) is an independent state-owned body with responsibility for the transportation of energy, operating these systems and ensuring the economic operation of the high voltage electricity grid in a competitive market.

GAS SUPPLY

Responsibility for the natural gas pipeline infrastructure lies with Ervia (formerly Bord Gáis Éireann), which is wholly owned by the state. The gas supply market has, however, been opened to competition in recent years for both residential and business customers. Most of the energy supply companies providing electricity (listed above) also operate in the market to supply natural gas to customers.

TELECOMS INFRASTRUCTURE

Following the privatization of Ireland's telecoms network in 1999, telecommunications networks (landline and mobile) in Ireland are privately owned by a number of service providers in a regulated competitive market providing customers with a wide range of advanced digital services. The Commission for Communications Regulation is the regulator of Ireland's telecommunications sector with responsibility for television broadcast services and wireless communications services.

TRANSPORT

Most of the transport system in Ireland is in public hands. The Irish road network has evolved separately in the two jurisdictions into which Ireland is divided, while the Irish rail network was mostly created before the partition of Ireland. In the Republic of Ireland, the Minister for Transport, acting through the Department of Transport, is responsible for the state's road network, rail network, public transport, airports and several other areas.

ROADS, BRIDGES AND TUNNELS

The primary and secondary roads in Ireland are owned by the state, with a significant section of the road network having been built using
private or public-private funds (mostly as part of projects structured by way of Public-Private Partnership (PPP)), and are operated as toll roads. Approximately one-third of the motorway network is operated by PPPs, with the other sections managed by motorway maintenance and renewal contract operators.

HEAVY RAIL AND BUS SERVICES

Public transport is mainly in the hands of Córas Iompair Éireann (CIÉ), which is a statutory corporation, and its subsidiaries – Bus Átha Cliath (Dublin Bus), Bus Éireann (Irish Bus), and Iarnród Éireann (Irish Rail).

These three subsidiaries are largest internal operators of public transport in Ireland:

- **Bus Átha Cliath/Dublin Bus** provides bus services in the Greater Dublin area, including most bus services within Dublin city and County Dublin;

- **Bus Éireann/Irish Bus** provides intercity and regional bus services outside Dublin city and county and from Dublin to the rest of the country, as well as operating the city buses in Cork, Limerick, Waterford, and Galway and a number of other small urban bus systems; and

- **Iarnród Éireann/Irish Rail** operates InterCity, Commuter and DART trains, and – together with Northern Ireland Railways – the Dublin–Belfast Enterprise train

(collectively the CIÉ Companies and each a CIÉ company)

CIÉ does not enjoy a monopoly in the provision of public transport services but rather it is granted a direct award contract for particular routes and private operators may not compete directly on any route for which a CIÉ Company has been granted an exclusive license. Each year, funding is provided to CIÉ Companies for the provision of socially necessary public transport services in Ireland, in order to fund the difference between income from fares and the cost of operating such non-profit making (or loss-making) services. The Public Service Obligation scheme for public transport is the scheme through which the operating costs of providing financially unviable transport services in Ireland are subsidized by the state.

LIGHT RAIL

The Dublin Area Rapid Transit system (stylized as the DART) is an electrified commuter rail railway network serving the coastline and city center of Dublin which is operated by the state through Iarnród Éireann.

The Luas is Dublin city's Light Rail Transit System (tram), carrying over 90,000 passengers per day. The French public transport operator Transdev operates and manages the Luas rail system under a contract with Transport Infrastructure Ireland (TII), which is the state body responsible for the Luas. The current contract will run until 2025.

AVIATION AND AIRPORTS

Aviation in Ireland is privatized but the government currently owns the main airport infrastructure, consisting of three state-owned airports – Dublin, Cork and Shannon Airports, which are the three largest airports in the country. DAA plc is a public limited company responsible for the management, operation and development of Dublin and Cork airports. Shannon Group plc is also a public limited company responsible for the same roles in respect of Shannon Airport. Both companies are state-owned.

Ireland has a number of regional airports. However, improvements made to surface transport infrastructure such as motorways, has reduced the role of these regional airports in the provision of domestic connectivity. The Irish government provides support for these airports through Ireland's Regional Airports Programme, with airports located in Donegal, Kerry, Knock and Waterford receiving funding.

PORTS

Ireland's ports are publicly controlled with a high level of private-sector involvement in the provision of infrastructure and services. The Irish government's stated objective is to facilitate a competitive and effective market for maritime transport services.

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES, HUBS AND PRISONS)

These are owned for the most part by the public sector, with the exception of social housing (please see below). The private sector is often involved in the design, build, financing, operation and maintenance of the structure. The majority of social infrastructure assets in Ireland are directly financed by the state.
EDUCATION

Primary schools – a large majority of primary schools (approximately 96%) are owned by and under the patronage of religious denominations with approximately 90% owned by the Catholic Church and other private owners.

Secondary schools – the land and buildings are for the most part, owned by the state or Minister for Education (in many cases where ownership is vested in the religious order and Educational Trustee Boards). In all cases, the capital costs associated with secondary schools are borne by the state.

PRISONS

All prisons in Ireland form part of the Irish Prison Service and are owned by the state, with political responsibility vested in the Minister for Justice and Equality.

HOSPITALS

Ownership of public hospitals is vested in public sector entities and religious orders operating within the Health Service Executive (HSE). There are a number of private hospitals owned by various individuals and entities.

SOCIAL HOUSING

The Housing Agency is a government body that works with the Department of Housing, Planning and Local Government, Local Authorities and approved housing bodies (being voluntary housing organizations approved under the Housing (Miscellaneous Provisions) Act 1992 for the purpose of accessing assistance from local authorities for housing provision) in the delivery of housing and housing services. Approved housing bodies receive both public and private investment. There are several purchase schemes which have been developed to enable tenants to buy their own homes.

DEFENSE

Defense assets are owned by the public sector.

WASTE

Waste disposal and recovery activities require an authorization in accordance with the Waste Management Act 1996 (as amended), subject to certain limited exceptions. These services are provided by private companies, once granted with the requisite license/permit or certificate from the Environmental Protection Agency or relevant local authority, depending on the authorization required.

WATER

The Irish government established Irish Water in 2013. This is the state's water utilities company, which is now a subsidiary of the state-owned Ervia (formerly Bord Gáis Éireann), with responsibility for the delivery of public water and waste water services, taking over the role that was previously held by local authorities.

Irish Water is regulated by the CRU from an economic perspective, with responsibility to protect the interests of water consumers, ensuring the services are delivered in a sustainable manner and to oversee that the company operates in an efficient manner.

The Environmental Protection Agency is responsible for supervising Irish Water’s supply of drinking water and the authorization of discharges from waste water treatment plants.

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Are there special rules for investing in energy and infrastructure?

There are no special rules nor any specific regime governing or restricting investment in energy or infrastructure projects in Ireland, over and above existing regulation for investors and funders more generally. However, depending on the sector involved, investment may be subject to legislative or regulatory control (e.g. merger control and state aid rules).

With regard to the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be
made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land may require planning permission and a project may require environmental permits and/or other sector specific regulatory consents or licenses.

If a public body (e.g. a government department or local authority) is procuring a project and the public body is to benefit from central government funding towards the cost, the project will be subject to governmental approval. Key sector-specific issues are flagged in the sections below.

**ENERGY INFRASTRUCTURE**

The CRU has responsibility to grant, revoke and enforce licenses for the purposes of supplying electricity. Application forms can be downloaded and submitted directly to the CRU. Prospective suppliers must fulfill a number of industry requirements as set down by ESB Networks (responsible for market design) and the Single Electricity Market Operator (SEMO), as facilitator of the continuous operation and administration of the SEM.

Following the grant of a license, licensees may request consent from the CRU for subsequent actions such as an assignment and transfer, change of control, extensions and revocation.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, it should be considered if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.

**TELECOMS INFRASTRUCTURE**

ComReg is the independent regulatory authority that regulates the telecoms sector and it is the designated national regulatory authority under the European common regulatory framework for electronic communications networks and services. It has extensive powers, which include to:

- issue licenses to provide telephony services;
- conduct market reviews and impose obligations on operators found to have significant market power; and
- enforce compliance and resolve disputes between operators and between operators and their customers (including commercial disputes).

Following a review by the European Commission of the regulatory framework for electronic communications, the European Electronic Communications Code (the EECC) entered into force in December 2018. Ireland has until December 21, 2020, to implement the directive into national law. The adoption of the EECC marks a significant revision of the EU framework for telecoms regulation. It operates to consolidate and update the existing EU legislation regulating electronic communications services and networks. The core objectives of the EECC are to promote connectivity to high capacity networks across the EU, develop an internal market for telecoms, and provide greater protection for consumers.

The broad inclusion of interpersonal communication services within the scope of an electronic communication service will mean that telecom companies outside the scope of the regulatory regime at present will have to consider, among other things, their obligations under the EECC and adapt as needed.

No foreign ownership restrictions apply to communications services.

**TRANSPORT INFRASTRUCTURE**

The National Transport Authority (the NTA) is responsible for issuing licenses for public passenger services. The application can be downloaded from and submitted through the NTA’s website and a completed map of the proposed route is required (among other things) to be submitted with the application.

Any attempt to provide a transport service without having obtained a license is a contravention of the Public Transport Regulation Act, 2009.

**PLANNING AND BUILDING CONTROL**

When buying or leasing a property in Ireland, it is important to obtain satisfactory evidence of compliance with planning permission and
building regulations regarding the construction of the property and any significant post-construction works.

With the exception of certain specified changes of use and limited forms of development which are exempted, permission must be obtained from the relevant local authority and/or An Bord Pleanála in order to make any material change of use of property or to construct buildings.

Unlike in the UK, there is no statutory planning register which can be checked to verify that a building has been constructed in accordance with the relevant planning permission(s).

Building control regulations regulate the design and construction of buildings, extensions or certain material change of use, their services, fittings and equipment. They deal with, among other things, accessibility, health, safety and welfare of users, and energy efficiency.

Fire Safety Certificates and Disability Access Certificates must be obtained from the Building Control Authority in respect of the design of works before commencement. Once the relevant works have been completed the developer must obtain a Certificate of Compliance on Completion from an Assigned Certifier in order to verify that the works comply with building regulations. This certificate must then be registered with the national Building Control Management System.

What is the applicable procurement process?

Public procurement in Ireland is based on the EU regime, which has as its objective the free movement of goods, services and works within the EU. There are some sector-specific regulations as set out below.

The legislation around public procurement is applicable where any public sector bodies outsource the delivery of these goods and services, this includes all government departments/offices, local and regional authorities, health authorities, commercial and non-commercial state bodies. If the relevant procurement is in relation to a major infrastructure project or the contract exceeds EU thresholds, the procurement is regulated.

Contracts below the EU thresholds which are funded or part-funded from public funds or awarded by private sector entities, should, as far as possible, be awarded in accordance with the national guidelines.

The basic principle of public procurement is that there should be a competitive process, affording an equal opportunity for all suppliers to compete. The type of process will depend on the value and nature of the requirement. There is a legal obligation to engage in a competitive process for contracts above EU thresholds and award them in accordance with procedures set out in EU public procurement directives.

In most cases, the public sector body will need to publish a contract notice in the Office Journal of the EU (OJEU) and typically run one of the following procedures:

- **Open Procedure** - The open procedure is the most commonly used procedure in Ireland for public sector bodies. It allows an unlimited amount of offers and, therefore, unlimited competition.

- **Restricted Procedure** - The restricted procedure is a two-stage procedure that takes longer to run than the Open Procedure and is more complicated to run. It is used where there is a need to pre-qualify suppliers or where there is evidence that the number of potential suppliers is very large or possibly where a contracting authority wants to limit the number of people who will have access to confidential and/or sensitive information.

- **Competitive Dialogue Procedure** - This procedure provides for some clarification and optimization after the final call for tenders making it better for highly complex outcome-based procurement. It is a more structured procedure than the Competitive Procedure with Negotiation and could be said to offer more safeguards for contracting authorities.

- **Competitive Procedure with Negotiation** - This is a two-stage procedure that generally starts with a call for competition. The contract notice must make it clear that this procedure is being used. There is an obligation on the contracting authority to provide a description of its needs, to specify the award criteria and to define the minimum requirements that must be met by all tenderers.

When fixing the deadline for receipt of tenders or requests to participate, contracting authorities must take account of the complexity of the contract and allow sufficient time for submitting the necessary information and preparing tenders.

An investor may also choose to invest in a project (for example, by way of acquiring equity in a private sector partner) that has already
been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than the procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement related considerations that need to be borne in mind.

OTHER APPLICABLE LAW

The Freedom of Information Act 2014 (the FOI Act) applies to public bodies. Any person may request “records”, including records relating to tendering procedures. There are exemptions under the FOI Act regime which apply where records are confidential or commercially sensitive. Tender-related records are not exempt as a class. Tenderers are normally requested to indicate in their tenders, with supporting reasons, any information which should be regarded as confidential.

CODE OF PRACTICE ON THE GOVERNANCE OF STATE BODIES

Commercial and non-commercial state bodies in Ireland are subject to the Code of Practice on the Governance of State Bodies (2016) (Code). The Code provides that it is the responsibility of the relevant body to satisfy itself that the requirements for public procurement are adhered to. Transparency is a key theme of the Code and competitive tendering is advocated as the standard procedure in the procurement process of state bodies.

FINANCING ENERGY AND INFRASTRUCTURE

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector and may require that any refinancing gains to be shared with the public sector.

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What are the most common forms of funding / investing in energy and infrastructure?

Funding

Sources of financing are mostly provided by leading foreign financial institutions and private investors but also by investment funds offering structured solutions for public projects established within a public-private partnership.

Many public infrastructure projects have been delivered by way of a public-private partnership, which is an arrangement between a public authority and a private partner under a long-term contract.

The funding structure has been used most often in the building of economic infrastructure such as roads.

Other common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bond finance; and mezzanine debt.

Ireland's location has provided it with an abundance of renewable energy potential, and this potential is being realized with the development of a highly active onshore wind energy industry. Ireland's progress towards its renewable energy targets has proven attractive to foreign investors and there is significant investor demand for opportunities in this area.

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Restructuring

Enforcement and sanctions
When can there be regulatory investigations?

The Central Bank of Ireland may carry out an investigation where it is concerned that a prescribed contravention under the Central Bank Act 1942 (as amended) has occurred.

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What regulatory penalties may apply?

The Central Bank of Ireland has a wide range of enforcement tools, including, but not limited to, administrative sanctions, investigations (leading to a public inquiry), directions to refund or withhold money charged, fitness and probity investigations, refusal/cancellation/revocation of registrations, supervisory warnings, and repayment of the Central Bank of Ireland's costs.

The fines that can be imposed as administrative sanctions are capped at EUR10 million or 10% of turnover for a corporate entity and EUR1 million (and/or disqualification) for an individual. Fines made following an inquiry will be determined having regard to the financial circumstances of the entity/individual.

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What criminal penalties may apply?

Following judicial proceedings, Irish courts have powers to impose criminal penalties in certain cases, including:

• financial crime, including money laundering and terrorist financing (or their equivalents);
• fraud, misrepresentation, dishonesty or breach of trust;
• offences under legislation relating to companies or financial services providers;
• market manipulation, insider dealing, revenue law; and
• conducting regulated activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Advance of loan

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

Transfer or Assignment of a Debt Under a Loan

A written instrument transferring or assigning a debt under a loan is, in principle, subject to Irish stamp duty, chargeable at 7.5%. However, provided the debt constitutes loan capital and does not have certain offensive features (such as a rights of the same kind as shares in the capital of a company or rights to conversion into shares or other securities), the written instrument assigning or transferring such debt should be exempt from stamp duty (loan capital exemption). Alternatively, an exemption applies where the instrument is an agreement for the sale, or a transfer on sale, of a debt or part of a debt where such sale occurs in the ordinary course of the business of the vendor or the purchaser (debt factoring exemption).

Transfer or assignment of a mortgage, debenture or other security
Generally speaking, there should be no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security. However, most security interests created by Irish companies must be registered with the Companies Registration Office to perfect the security and ensure it is valid against third parties. The grant of most security interests over Irish real estate should also be registered at the Land Registry to ensure that the security interest takes effect as a legal charge. It would be unusual for the fees payable for such registrations to be a material amount. Other forms of registration may also be required (or be advisable), depending on the nature of the asset over which security is taken. Such registrations may also require the payment of fees.

**Transfer or Assignment of a Debt Security (e.g. a Bond)**

There is no charge to stamp duty on the issue of a debt security in Ireland whether in bearer or registered form.

**BEARER BONDS**

No charge to stamp duty should arise on the transfer of a bearer bond as the title to bearer bonds can pass by delivery, (i.e. no stampable written document needs to be executed in order to transfer a bearer bond).

**REGISTERED BONDS**

The transfer of a debt security is in principle subject to stamp duty at the rate of 7.5% if the instrument is executed in Ireland or wherever executed, if it relates to any property situated in Ireland or any matter or thing done or to be done in Ireland. However, there are a number of exemptions (subject to certain conditions being satisfied) from this including the loan capital exemption and debt factoring agreement exemption, as referenced above. In addition, the transfer of bonds issued by an Irish securitization vehicle are exempt from stamp duty.

**Depositary and Clearing Systems**

**BEARER BONDS AND REGISTERED BONDS**

Stamp duty does not arise on the transfer of securities to and from a central counterparty (CCP) subject to certain conditions being satisfied. This facilitates a system for the clearing and settlement of transactions where the member firms of the exchange or market will submit orders for securities to the central counterparty and the trades will be settled against the central counterparty as the member firms who submitted the order will be unaware of the counterparty on the other side.

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**Do tax authorities take priority on enforcement?**

Generally speaking, secured lenders and secured debt holders (excluding holders of floating charges) take priority over Revenue claims on enforcement of security.

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**Is withholding tax on interest payments applicable?**

Unless an exemption applies, where a payment of interest with an Irish source is paid under a loan which is intended or expected to have a duration of a year or more, an amount equal to the basic rate of the interest payment is required to be withheld and paid to the Irish Revenue Commissioners. The current rate of Irish interest withholding tax is 20%.

The most commonly relied on exemptions to ensure that interest payments made by Irish companies can be made free of Irish interest withholding tax include:

- the exemption for interest paid on an advance from a bona fide Irish tax resident bank (as defined in the legislation and including interest paid in respect of syndicated debt held by a bona fide Irish bank);

- where the interest is paid in the ordinary course of a trade or business carried on by an Irish corporate borrower to a company (1) which is regarded as being a resident of a relevant territory (i.e. a Member State of the European Union (other than Ireland) or a country (a) with which Ireland has a double taxation agreement in force or (b) with which Ireland has signed such a double taxation agreement which will come into force once all the ratification procedures have been completed) under local law and such territory...
imposes a tax that generally applies to interest receivable or (2) where the interest is exempt from tax under the double tax treaty or would be exempted from the charge to income tax under the relevant treaty which has been signed but not yet have the force of law on or before the date of payment on the interest, if such relevant Treaty had the force of law when the interest was paid tax (provided in both cases the interest is not paid to the recipient company in connection with a trade or business carried on by the recipient company in Ireland through a branch or agency);

• the exemption applicable to quoted Eurobonds (applicable to interest paid on a security which is quoted on a recognized stock exchange);

• payments to another company which advances money in the ordinary course of a trade and has made the required notifications to the Irish Revenue Commissioners;

• reliance on a double tax treaty; and

• reliance on the EU Interest and Royalties Directive (Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States) as implemented by Irish law (the key requirement being that the lender and the borrower meet the association requirement).

The analysis described above is applicable to both interest payments under a loan or other form of debt security. The quoted Eurobond exemption is particularly relevant to debt securities.

Are foreign lenders and debt security holders subject to tax on interest payments?

The lender should not (in practice) be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch). The same analysis would apply to interest payments made in respect of debt securities.

Key contacts

Conor Houlihan
Partner
DLA Piper Ireland
conor.houlihan@dlapiper.com
T: +353 1 4365465
Capital markets and structured investments

Issuing and investing in debt securities

*Are there any restrictions on issuing debt securities?*

Pursuant to the Italian Civil Code, a company may issue debt securities for an amount not exceeding twice its share capital, the legal reserve and the available reserves of that company, as set out under its last approved balance sheet. These constraints do not apply in the following cases:

- debt securities issued in excess of the limit set out above which are underwritten by institutional investors subject to prudential supervision;
- debt securities secured by a first-ranking mortgage;
- debt securities to be listed on a regulated market or negotiated on a multilateral trading facility (As a general remark, it is not possible to state a precise timeframe for listing which will be valid for all the issuers. Timeframes for the admission to trading may vary depending on the market (ie whether Borsa Italiana or EuroTLX), the type of issuer and/or the type of security. As a rule of thumb, the admission procedure can take from one week to a couple of months (or even longer if the relevant market requires more information from the issuer));
- convertible bonds which grant the right to purchase or underwrite shares;
- special authorization given by governmental authorities on national economic interest grounds; and
- application of special laws relating to particular categories of companies (eg in relation to banks by virtue of the provisions set out under the Consolidated Banking Act).

Furthermore, pursuant to the Prospectus Regulation, and relevant implementing measures in Italy, an issuer shall draft and file with CONSOB a prospectus in order to offer the debt securities to the public and/or list such debt securities on a regulated market. Such provision is valid and effective to the extent that an exemption does not apply.

*What are common issuing methods and types of debt securities?*

Debt securities are most commonly issued by means of either a standalone prospectus or a base prospectus.

Several different types of debt securities are offered and/or listed in Italy. Among the others, some common forms include:

- plain vanilla notes (including, *inter alia*, fixed-rate notes, floating-rate notes, zero-coupon notes fixed to floating rate notes, step-up notes, step-down notes);
What are the differences between offering debt securities to institutional / professional or other investors?

A different disclosure regime exists in the case of offers addressed to retail investors or institutional/professional investors (named ‘qualified investors’). In the latter case, the Prospectus regulation clarifies that a prospectus is not necessary (unless the securities are subsequently traded on a regulated market).

The disclosure regime also depends on the denomination of the debt securities offered. To this extent, debt securities having a denomination amount that is lower than €100,000 are usually directed to retail investors and offered for subscription by means of a prospectus approved by CONSOB, whereby debt securities having a denomination that is equal to or higher than €100,000 shall be considered as a wholesale issue and a less rigid disclosure regime is applicable.

When is it necessary to prepare a prospectus?

Under the Prospectus Regulation, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer would not be deemed to have been made to the public if it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per European Economic Area state or where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a Prospectus Directive compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid publishing a prospectus.

What are the main exchanges available?

Borsa Italiana S.p.A. provides different markets where debt securities may be traded. In this respect, the primary market in Italy is the MOT (Mercato Telematico delle obbligazioni e dei titoli di Stato). Pursuant to the Rules of the Markets organized and managed by Borsa Italiana S.p.A., the financial instruments that may be traded on the MOT are bonds (excluding convertible bonds), sovereign debt, Eurobonds, asset-backed securities, structured bonds, covered bonds and other debt securities and instruments tradable in the monetary market.

The MOT consists of two segments:

- DomesticMOT, for debt securities that are settled through Monte Titoli S.p.A., according to the Instructions accompanying the Rules of the Markets organized and managed by Borsa Italiana S.p.A.; and
- EuroMOT, for debt securities that are settled through Euroclear/Clearstream, according to the Instructions accompanying the Rules of the Markets organized and managed by Borsa Italiana S.p.A.
Furthermore, there are other trading venues – in particular Multilateral Trading Facilities – where debt securities may be traded:

**ExtraMOT**

The ExtraMOT is a multilateral trading facility, regulated by Borsa Italiana S.p.A., for trading corporate bonds issued by Italian and foreign companies which are already listed on other regulated EU markets, as well as non-listed bonds and debt instruments issued by Italian small and medium-sized enterprises (SMEs).

**ExtraMOT Pro**

The ExtraMOT Pro is the professional segment of the ExtraMOT dedicated to trading, *inter alia*, bonds (including convertible bonds), commercial papers and project bonds, generally issued by Italian SMEs. Trading is only open to professional investors on the ExtraMOT Pro.

**EuroTLX**

EuroTLX is the multilateral trading facility organized and managed by Borsa Italiana S.p.A., targeted to non-professional and professional investors trading in retail size and mainly focused on fixed income securities.

*Last modified 22 Jan 2020*

**Is there a private placement market?**

The private placement market in Italy is underdeveloped compared to, for instance, the UK or the US. According to a paper published by the Bank of Italy, there were 235 issuances of debt securities in the period 2012–2014.

Having said that, the private placement market in Italy is growing due to the introduction of so-called minibonds, ie debt securities issued by Italian non-listed companies (generally small and medium-sized enterprises (SMEs)) and usually negotiated on the ExtraMOT Pro.

Efforts have been made by the Loan Market Association and International Capital Markets Association to standardize private placement documentation.

*Last modified 22 Jan 2020*

**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Under Italian law, the issuer, offeror, guarantor, or the persons responsible for the information contained in the prospectus, shall be liable, each in relation to the extent of their own duties, for damages caused to the investor placing reasonable faith in the truth and accuracy of information contained in the prospectus, unless it is proved that all due diligence was adopted for the purpose of guaranteeing that the information in question complied with the facts and that no information was omitted that could have altered the sense thereof. Investors suffering loss are entitled to bring a civil action for negligent misstatement or misrepresentation, and also criminal law sanctions may be imposed in such cases.

**Investing in debt securities**

Under Italian law, a noteholders' meeting may amend the terms and conditions of the debt securities provided that certain conditions regarding the constitutive/deliberative *quorum* are fulfilled. To this extent, an extraordinary resolution passed by a qualified majority of noteholders binds all the noteholders.

In addition, in the case that the issuer is an institution falling within the scope of the BRRD the potential investor should be aware that such institution may be subject, upon certain conditions, to resolution measures. In particular, the relevant resolution authority could apply certain resolution tools including, among others, the bail-in tool. Consequently, the potential investor may be subject to the risk that the resolution authority will exercise the write-down or conversion power in respect of the relevant institution's liabilities (including the securities purchased by the investor).
Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

In general terms, the establishment, marketing and management of Italian investment funds (having either contractual or corporate form) are regulated activities, exclusively reserved to duly licensed entities, subject to authorization requirements and ongoing supervision and to be performed in compliance with the relevant rules and regulations.

Collective Investment Schemes

Under the Italian regulatory framework, the overall operation and activities of Collective Investment Schemes shall comply with a set of rules and provisions, involving, inter alia:

- disclosure and authorization procedures vis-à-vis the competent supervisory authorities in relation to:
  - the funds, especially when qualifying as retail funds (in this context the applicable provisions set forth different requirements regarding, inter alia, minimum content of the fund documents, disclosure obligations of such fund documents vis-à-vis the supervisory authorities, investment limits, risks fractioning and diversification requirements etc); and
  - the management companies (in this context, the applicable provisions require, inter alia, the obtainment of an authorization to perform collective asset management activities, the compliance with sound and prudent management safeguards, as well as with minimum capital requirements and ongoing prudential thresholds, transparency provisions towards the investors and rules of conduct); and
- procedures to be followed for the promotion, offer and marketing of the funds, differently modulated based on the cross-border operation, if any, the target investors (retail or professional), the type of vehicles etc.

Generally, the rules set forth for retail funds are more stringent than those relating to reserved funds exclusively for professional investors. Fewer and less stringent investment limits, for example, are imposed on reserved funds, as well as less onerous disclosure and reporting requirements.

What are common fund structures?

Different categories of funds may be identified, based, inter alia, on the:

- subscription and redemption modalities adopted (open-ended or closed-ended funds);
- types of subscribers addressed (retail or reserved);
- risk level involved (recourse to leverage on a substantial basis or not); and
- relevant investments to be made (real estate funds, private equity funds, master-feeder structures, fund of funds etc).

In this context, the most common investment structures, as anticipated, can be divided between:

- investment vehicles having a contractual form (ie investment funds, either qualifying as Undertakings for Collective Investment in Transferable Securities (UCITS) or alternative investment funds (AIFs)), established and managed by a manager as a segregated pool of assets divided into units and collected, through one or more issues of units, among a plurality of investors, managed as a whole in the interest of (and independently from) the unit holders; and
- corporate vehicles (ie Società di Investimento a Capitale Variabile (SICAV) and Società di Investimento a Capitale Fisso (SICAF), depending on the open-ended or closed-ended nature, either qualifying as UCITS or AIFs) which may be both self-managed or externally
What are the differences between offering fund securities to professional/institutional or other investors?

Retail funds

Italian retail funds are subject to stringent regulatory requirements, comprising, *inter alia*, minimum contents of the fund rules, authorization procedure vis-à-vis the Bank of Italy, approval of the management rules and of its subsequent amendments, investments' limits and risk mitigation, fractioning and diversification criteria.

Institutional/professional funds

Italian reserved funds, as expected, are subject to fewer and less stringent investment limits, as well as less disclosure and reporting requirements towards the relevant supervisory authorities. No authorization is required for the establishment of reserved funds and generally the fund rules are not subject to approval by the Bank of Italy.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

As anticipated, the establishment, marketing and management of Italian investment funds (having either contractual or corporate form) represent activities exclusively reserved to duly licensed entities and subject to authorization requirements and ongoing supervision. Such activities, as a consequence, are to be performed in compliance with all the relevant applicable rules and regulations. Every potential breach or evasion (e.g., ‘ghost companies’) of the aforesaid rules and regulations may trigger the application of administrative and criminal sanctions associated to an unlawful exercise of financial activity or to the violations of the applicable regulatory provisions.

Investing in funds

No specific issue arises. Any specific risk and the overall risk profile connected with any investment in a fund is mandatorily disclosed in the fund's offering and subscription documentation.

Managing and marketing debt/hedge funds

Are there any restrictions on marketing a fund?

Italy selling restrictions

The offer of securities in Italy is covered under the CONSOB financial promotion regime provisions, respectively implementing *Undertakings for Collective Investment in Transferable Securities Directive* regime and *Alternative Investment Fund Managers Directive* regime.

*Undertakings for Collective Investments in Transferable Securities (UCITS)*
UCITS, including those established in Italy, have an EU passport which enables fund promoters to create a single product for marketing in all EU member states and, on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

**Alternative Investment Funds (AIFs)**

Under the Alternative Investment Fund Managers Directive, marketing is defined as: a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (please note that NPPR has not been yet implemented in Italy).

**Reverse solicitation and the definition of ‘marketing’**

In general terms, reverse enquiry mechanisms refer to situations in which clients contact managers, on their own initiative, in order to subscribe for units or shares of a fund, and no placement or marketing activity are performed by the managers towards such clients.

Italian law and regulation does not contain specific provisions on the reverse solicitation scheme. The qualification of the operation as a ‘genuine’ reverse solicitation, in this sense, will derive from an assessment, made by the competent Italian supervisory authorities, of the procedural and documentary evidences underlying the transaction. More precisely, the Italian supervisory authorities, in order to prove the legal construction of the reverse inquiry, adopt a stringent ‘substance over form’ approach.

In relation to the definition of ‘marketing’, the Consolidated Financial Act defines this as ‘the offer, also indirect, on the initiative or on behalf of the manager, of the AIF units and shares managed, addressed to resident investors or those with a registered head office in the EU’.

**Are there any restrictions on managing a fund?**

Fund management in Italy is regulated under the Consolidated Financial Act, various statutory instruments and the supervisory authorities’ rules and regulations. The Bank of Italy is mainly responsible for regulating funds and fund managers, as well as the criteria for the obtainment of the relevant authorizations.

The various restrictions imposed by the aforesaid provisions (including, inter alia, structuring, management autonomy and independence, conflict of interest and remuneration issues) shall be proportionate to the managers’ size, internal organization, scope and complexity of activities.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive (as implemented in Italy) and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the Undertakings for Collective Investment in Transferable Securities Directive.

More precisely, the authorization procedure with the Bank of Italy to perform collective asset management activities, is granted upon positive evaluation of, inter alia, the business plan, activities plan and organizational structure of the manager, integrity, professionalism and independence of its directors and controllers' integrity, and professional competence of its shareholders and their representatives.

The entity willing to exercise the collective portfolio management activity must submit to Bank of Italy certain documentation confirming the above prerequisites, and the Bank of Italy will have 90 days from the filing to grant or deny authorization (this term may be suspended in case the Bank of Italy requires clarifications or additional information).

In terms of incorporation costs, the Bank of Italy usually requires the Società di Gestione del Risparmio (SGR) to be provided with excess cash in order to cover incorporation costs without reducing the minimum corporate capital.
Special provisions are set forth for SGR managing assets below predefined thresholds (so called SGR sotto soglia), which are subject, inter alia, to simplified capital and authorization requirements, assets evaluation criteria, control functions, outsourcing, conflict of interest and portfolio and management regimes, as well as to simplified guidelines on remuneration.

**Entering into derivatives contracts**

*Are there any restrictions on entering into derivatives contracts?*

An Italian client entering into derivative contracts in Italy might be a private or corporate client or a public client (such as central and local authorities).

**Italian private and corporate clients**

There are no restrictions on private or corporate clients entering into derivatives contracts.

Nevertheless, when entering into a derivative contract with a corporate client it is advisable to check whether the relevant constituting documents and by-laws of such client:

- Encompass any provision evidencing the authority of the party entering into this type of agreement and the performance of its obligations under such agreement; or
- Encompass any limit in relation to entering into derivatives contracts (in particular, it may be possible that only derivatives contracts with hedging – and not speculative – purposes may be permitted).

**Italian public clients**

As of June 2008, all Italian public authorities (including local entities, regions, metropolitan cities etc) are prohibited from entering into any type of new derivative contract.

**Banks authorized in Italy and/or authorized to carry out in Italy financial services on a cross-border basis**

Entering into derivative contracts entail the provision of financial services. Therefore, in order to provide such service, banks and/or financial intermediaries selling a derivative product must be duly authorized to carry out this service (on its own account) in Italy, whether on a cross-border basis or by establishing a branch.

In the event that the bank/financial intermediary is at the same time advisor and counterparty to the client of the derivative contract, Italian law provides a wide range of further information to be disclosed to the client (in order to comply with both appropriateness and suitability rules in favour of the client).

**What are common types of derivatives?**

In Italy, derivative contracts are entered into for the following purposes:

- hedging; and
- trading (including trading for speculation purposes).

Derivatives may be traded over-the-counter (OTC) or on an organized exchange (ETD, Exchange Traded Derivatives).

The most common types of derivative contract in Italy entered into for hedging purposes are:

- swaps (in particular interest rate swap or currency swap), as OTC derivative; and
Derivative contracts (in particular OTC derivative contracts) are also regulated by the European Market Infrastructure Regulation (EMIR) and the implementing regulation of Regulatory Technical Standards (RTS) which attempts to ensure the same degree of protection to clients within all EU countries by providing comprehensive information and transparency on over-the-counter derivative position, and reduce counterparty risk by increasing the use of central counterparty clearing.

It is worth noting that the derivatives market has significantly changed in light of the implementation of the MiFID II starting from January 2018, as summarised above.

Due to a recent increase in disputes over OTC derivatives in Italy, a specific focus is attributed to the following items:

- complete disclosure of all costs related to the initial mark-to-market of the OTC derivative contract (distinguishing each line item such as hedging cost and bank remuneration); and
- comprehensive information to be provided to the client before the entering into the derivative contract with particular reference to the appropriateness and suitability of the derivative.

The risk related to the non-disclosure of the above information to the client is that the derivative contract might be declared null and void by an Italian court. Pursuant to current case law in Italy a client (professional or retail) shall explicitly receive detailed information and give its consent on the value of the hedging costs and any further charge applied to the derivative transaction to be concluded by it.

According to the provisions of EMIR the counterparties to derivatives transactions must verify the need to enter into specific arrangements for risk reducing. More particularly, for those transactions entered into between clients classified as FC (Financial Counterparties) or as NFC+ (Non-Financial Counterparties above a certain threshold) it will be necessary to establish security arrangements for the calculation and exchange, on a daily basis, of the “variation margin” to be exchanged between the parties to cover the relevant exposure under the master agreement governing the entire set of derivatives transactions.
Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

In general terms, under Article 106 of the Consolidated Banking Act the granting of loans in any form is reserved to duly authorized financial intermediaries enrolled with a Register kept by the Bank of Italy.

Specific exclusions are set forth in Ministerial Decree No. 53 of 2015, as well as cases in which the granting of loans is not considered as performed vis-à-vis the public.

In addition, loans can be granted also by Italian special purpose vehicles incorporated pursuant to the Italian Securitization Law. Such SPVs can carry out lending activity in the context of securitisation transactions, both in performing and non-performing scenario, in accordance with the specific requirements and limits set out under the Italian Securitization Law.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether the consumer-lending regime applies to their activities, in which case they will benefit from some additional protections and benefits (such as, for example, in terms of limitations to unilateral amendments by the finance party and transparency rules).

What are common lending structures?

Lending in Italy can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as the agent which fulfils certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific purposes, eg mortgage loans (including credito fondiario in relation to the financing of real estate assets), working capital loans, equity bridge facilities, bridge to cash facilities, project facilities and, letter of credit facilities and export facilities.

Finally, loans can be ‘in cash’ (finanziamenti per cassa), when the lender makes available to the borrower cash, or through the issue of documentary guarantees in favour of third parties in the interest of the borrower (finanziamenti per firma).

Loan durations

The duration of a loan can vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn on a roll over basis;
- an overdraft, provided on a short-term basis to support short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.
Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain contractual conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or bullet (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers entails a reduced set of protections and limitations in favour of the borrower.

Lending activities towards retail clients and consumers in particular are subject to stricter provisions and limitations.

Do the laws recognize the principles of agency and trusts?

In theory both principles are recognized as a matter of Italian law, although the trust concept is not yet commonplace in the Italian market and is seldom present in common lending structures.

From a practical perspective, in finance transactions with more than one finance party an agent is always appointed to act on behalf of the finance parties. It is extremely rare to have trustees appointed in connection with secured assets as generally trustees may encounter legitimacy issues in enforcing security interests. Parallel debt structure is not recognized/applicable in Italy.

Moreover, the agent usually is granted with reduced representation powers when such powers are granted by hedging banks which, for example, often have more flexibility in the management of the security interests assisting their claims (although subject to the restrictions of any intercreditor agreement).

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles.

However, certain principles of law cannot be contractually derogated and any contrary provisions contained in the finance documents would be null and void. As an example, finance documents may not provide for the exclusion of liability in case of gross negligence (colpa grave) or willful misconduct (dolo), and there are limitations to accrual and liquidation of interest (the Italian Usury Legislation applies in this case) and compound interest.

Furthermore, the enforcement of obligations of a party or the binding effect of such obligations may be limited by laws regarding bankruptcy, receivership, insolvency, liquidation, reorganization and any laws generally affecting the rights of creditors. In particular any payment made in advance in respect of its due date as originally agreed between the parties, including as a consequence of the
acceleration of such payment obligation or as a result of the operation of any mandatory prepayment provision contained in the finance documents, may, at certain conditions, be deemed ineffective vis-à-vis the bankruptcy administration of the payer, pursuant to Article 65 of the Bankruptcy Law, and accordingly the bankruptcy administration of such payer may request the restitution of such payment.

In addition, it is worth noting that:

- In banking transactions, a loan facility (from an accounting perspective) constitutes an asset of the lending bank rather than a liability but Directive 2014/59/EU (Bank Recovery and Resolution Directive or BRRD) and the relevant powers of the competent resolution authority may still be relevant eg in relation to a bank's potential liabilities to other syndicate members in a loan or an inter-creditor arrangement.

- If a financial institution happens to be a borrower, then its liabilities to repay debt may be subject to bail-in.

Specific types of lending

Specific to the area of mortgage lending is the issue of whether a lender falls within the recently formed Italian mortgage regime. The Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property, implemented in Italy through the Consolidated Banking Act and the Transparency Provisions, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The implementing regulations impose a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

Standard form documentation

It is quite common to see Italian law syndicated finance transactions governed by documentation based on forms published by the Loan Market Association (LMA), duly amended and integrated to be compatible with Italian law and Italian market standards. It is, however, also very common to see syndicated and bilateral finance transactions documented on bank standard form documentation prepared in-house or other simplified standard forms prepared by external legal advisors but diverging from the LMA.

Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the BRRD, which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpones the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the granting of guarantees and security are as follows.
Capacity/Corporate Benefit

It is important to check the constitutional documents of a company granting a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative. Under Italian law, directors have a general duty to promote the success of the company for the benefit of its members as whole; as such, they will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company.

Provided that the assessment of a corporate benefit is a matter of fact depending on a number of commercial and financial factors to be evaluated by the management body of the grantor of the guarantee and/or security, the market approach is often to have the members of the company approving the granting of the guarantee or security by written resolution and, if possible, to limit the guaranteed/secured amount to the direct monetary benefit arising to the issuer/grantor of the upstream or cross-stream guarantees or security (for example, the maximum guaranteed/secured amount would not exceed the amount of the intra-group/shareholders' loans made available to the issuer/grantor by the entity in the interest of which the upstream or cross-stream guarantees or security is issued/granted).

Insolvency

Guarantees and security may be at risk of being set aside under Italian insolvency laws if the guarantee or security was granted by a company within a certain period of time prior to the declaration of bankruptcy (dichiarazione di fallimento). For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within six months (or one year in the event that the underlying guaranteed obligation was not undertaken prior to (and not at the same time as) the issue/granting of the guarantee/security) of the declaration of bankruptcy (dichiarazione di fallimento) of the affected party.

In case of mortgage lending transactions governed by Section 38 of the Consolidated Banking Act (the so called 'Credito Fondiario' providing for certain requirements and limitations for the lenders in the selection of the remedies against the borrower in case of default), the period within which the mortgage assisting the financing may be set aside is reduced to 10 days.

Financial assistance

Financial assistance is subject to stringent regulation and limitations and it is therefore quite rare in the market to encounter a company providing financial assistance for the purchase of its own shares as a complex “whitewash” procedure is required in order to legally carry out such a transaction. Financial assistance in this context would include giving a guarantee or security in connection with the share purchase.

What are common types of guarantees and security?

Common forms of guarantees

Guarantees can take a number of forms.

A particular distinction worth remembering is between a personal guarantee (fideiussione) and an autonomous first demand guarantee.

- A personal guarantee (fideiussione) is a strictly regulated form of guarantee. Some of its main features are that:
  - it remains valid only if the underlying guaranteed obligation is valid;
  - the guarantor is entitled to object to a payment request by invoking the exceptions and objections which pertain to the debtor in the interest of which the guarantee was issued (the relevant debtor);
  - the guarantor may, before paying and under certain conditions, act against the relevant debtor to be released from the guarantee or to obtain due counter guarantees or counter security for the satisfaction of its claims after the payment; and
  - the guarantor is released if the guaranteed creditor has further financed the relevant debtor although it was aware of its difficult financial conditions.

- An autonomous first demand guarantee is intended as an instrument ensuring payment to the relevant creditor irrespective of the circumstances affecting the relevant debtor or the underlying guaranteed obligation if the contractual conditions/steps and
procedures provided by the relevant agreement are met.

Both of the above described guarantees shall expressly provide for the maximum guaranteed amount should the guaranteed obligation be a future/conditional obligation.

**Common forms of security**

There are four basic types of security interest that can be created under Italian law:

- a mortgage;
- a pledge;
- an assignment by way of security; and
- a privilegio (general or special lien).

Different types of security are suitable for securing different types of assets.

Under Italian law it is not possible for a single security to cover all of the assets of an Italian company, but only individual assets or classes of assets. Granting security over all of a company’s assets will tend to be achieved through the granting of the following multiple security interests:

- a pledge over movable assets (including shares/quotas of a company) or receivables;
- a mortgage over real estate assets or vehicles or ships;
- a privilegio (general or special lien) over movable assets different from vehicles and ships; and
- an assignment by way of security of receivables.

With respect to financial transactions it is customary to establish securities in the form of “financial collateral guarantees” according to Legislative Decree 170/2004 implementing in Italy Directive EC 2002/47. Financial collateral guarantees relating to financial transactions are documented as transfer-title pledge over assets granted by a transferor in favour of a transferee covering the exposure of one party to another under the relevant financial transactions.

In addition to the above, the following securities have been recently introduced in Italy:

- Security transfer of immovable asset; and
- Non-possessory pledge (not implemented).

**SECURITY TRANSFER OF IMMOVABLE ASSET**

A loan granted to an entrepreneur by a bank or another financial entity authorized to grant loans to the public in Italy can be secured by transferring to the creditor (or to a company in the creditor’s group authorized to purchase, hold, manage and transfer rights in rem in immovable properties) the ownership of an immovable asset of the entrepreneur or of a third party. Such transfer is subject to the condition precedent of the debtor defaulting. In such a case, the creditor is entitled to notify the pledgor its intention to enforce such security pointing out the amount of its credit; following such notification an independent valuer is appointed by the relevant Court in order to determine the value of the relevant immovable asset and consequently the sale process is carried out. The creditor shall pay to the pledgor the difference (if any) between the transfer price and the amount of its credit towards the pledgor.

**NON-POSSESSORY PLEDGE**

A non-possessory pledge allows the pledgor (who shall be engaged in entrepreneurial activities) to continue to use, transfer or otherwise dispose of the pledged assets for business purposes, provided that in such a case, the pledge would extend to any asset resulting therefrom. A non-possessory pledge agreement requires a written form and shall indicate a maximum secured amount. However, the pledge is enforceable vis-à-vis third parties only upon registration on an electronic register of non-possessory pledges to be set up. In this respect, since such electronic register has not been implemented, such security is not currently effective.

_Last modified 22 Jan 2020_

*Are there any other notable risks or issues around giving and taking guarantees and*
Giving or taking guarantees

To be valid, a guarantee needs to be in writing and signed by the guarantor. It can be provided also in case the Relevant Debtor is unaware of its issue.

The issue of a guarantee by a company does have some limitations regarding, *inter alia* the:

- preservation of the assets of the guarantor and the preservation of the rights of the creditors and stakeholders;
- misuse of corporate assets;
- exclusion of liability in case of gross negligence (*colpa grave*) or willful misconduct (*dolo*); and
- accrual and liquidation of compound interest.

Giving or taking security

A security document may need to be executed through notarial deed should it:

- contain a mortgage;
- contain a pledge over quotas over a limited liability company;
- contain a *privilegio speciale* (special lien); or
- contain an assignment of receivables *vis-à-vis* public entities.

In all other cases, it may be entered into either in notarial form or via exchange of commercial letters. In particular, this latter form is mainly utilized when the registration of the relevant instrument is not required by law.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder or a custodian, registration of the security in a company's books (as per the pledge of a company's shares) public registries and/or notice being given to (or, alternatively, acceptance being obtained from) third parties. Mortgages must be registered at the Land Registry, the pledges over a company's quotas must be registered in the Companies Registry, while the *privilegio speciale* (special lien) must be registered in the relevant book held at the competent courts. Failure to register means that the charge will be ineffective (*non opponibile*) against the liquidator, administrator or any creditor of the company and the money secured by the charge becomes immediately payable.

As for guarantees, for a period after a new security interest has been granted (known as the hardening period), there is a risk that such security is set aside in certain circumstances under insolvency laws.

**Financial regulation**

**Law and regulation**

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

*Italian Civil Code*

*Legislative Decree No. 385 dated 1 September 1993 (Consolidated Banking Act)*
Legislative Decree No. 58 dated 24 February 1998 (Consolidated Financial Act)
CONSOB Regulation No. 20307 dated 15 February 2018 (Intermediaries Regulation)
CONSOB Regulation No. 11971 dated 14 May 1999 (Issuers Regulation)
Ministerial Decree No. 53 dated 2 April 2015
Presidential Decree No. 600/1973
Legislative Decree No. 239 dated 1 April 1996
Presidential Decree No. 601/1973

Consumer credit

Legislative Decree No. 206 dated 6 September 2005 (Consumer Code)
Bank of Italy Regulation of 29 July 2009, as subsequently amended, containing the transparency provisions for banking and financial transaction and services and for correctness of the relationship between the intermediaries and their clients (Transparency Provisions)

Mortgages

Legislative Decree No. 385 dated 1 September 1993 (Consolidated Banking Act)

Corporations

Italian Civil Code

Funds and platforms

Bank of Italy Regulation on collective asset management services dated 19 January 2015 (Bank of Italy Regulation)
Ministerial Decree No. 30 dated 5 March 2015 (Ministerial Decree)
European Long Term Investment Funds Regulation (Regulation (EU) 760/2015)

Other key market legislation

Bank Recovery and Resolution Directive (2014/59/EU) as amended from time to time (recovery and resolution)
Capital Requirements Regulation (Regulation (EU) 575/2013) as amended by Regulation EU 876/2019 (capital requirements)
European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)
Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)
PRIIPs Regulation (Regulation (EU) 1286/2014) (packaged retail and insurance-based investment products)
Regulation on the prospectus to be published when securities are offered to the public or admitted to trading (Regulation (EU) 1129/2017) and repealing Directive 2003/71/EC and relevant delegated regulations 2019/979/EU and 2019/980/EU
Benchmark Regulation (Regulation (EU) 1011/2016) (indices used as benchmarks in financial instruments or financial contracts)
Capital Requirements Directive (2013/36/EU) (CRD IV)
STS Regulation (Regulation (EU) 2017/2402) (laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation)
Markets in Financial Instruments Directive (2014/65/EU) (MiFID II) (financial instruments)
Payment Service Directive (2015/2366/EU) (PSD2)
E-Money Directive (2009/110/EC), as subsequently amended and supplemented (EMD)
Directive for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (2015/849/EU), as amended by Directive 2018/843/EU (Fifth AML Directive) (money laundering)
Legislative Decree No. 231 of 21 November 2007 (AML Decree)
Law No. 108 dated 7 March 1996 as amended and implemented from time to time (Italian Usury Legislation)
Royal Decree Law No. 267 of 16 March 1942 as amended and implemented from time to time (Bankruptcy Law)
Law No. 130 of 30 April 1999 (Italian Securitization Law)
Legislative Decree No. 170 of 21 May 2004, implementing in Italy the Directive 2002/47/EC on financial collateral guarantees
Legislative Decree No. 170 of 21 May 2004, implementing in Italy the Directive 2002/47/EC on financial collateral guarantees
Legislative Decree No. 23 of 21 November 2007 (AML Decree)
Law No. 108 dated 7 March 1996 as amended and implemented from time to time (Italian Usury Legislation)
Royal Decree Law No. 267 of 16 March 1942 as amended and implemented from time to time (Bankruptcy Law)
Law No. 130 of 30 April 1999 (Italian Securitization Law)
Legislative Decree No. 170 of 21 May 2004, implementing in Italy the Directive 2002/47/EC on financial collateral guarantees
Legislative Decree No. 11, 27 January 2010, as amended from time to time (PS Decree) (payment services)
Legislative Decree No. 45, 16 April 2012 implementing Directive 2009/110/EC (e-money)
CONSOB Regulation 18592 of 26 June 2013, as subsequently amended and supplemented (Crowdfunding Regulation)

Securities listed on Borsa Italiana (Italian regulated market)

Rules of the Markets organized and managed by Borsa Italiana S.p.A.
Instructions accompanying the Rules of the Markets organized and managed by Borsa Italiana S.p.A.

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Regulatory authorization

Who are the regulators?

The Bank of Italy is the central bank of Italy and is entrusted with the supervision of banks and financial intermediaries, which are the entities entitled to carry out banking and financial activities vis-à-vis the public. In particular, the Bank of Italy pursues the objective of ensuring the stability and the efficiency of the banking and financial system and compliance with Italian rules and regulations. To this end, the Bank of Italy issues secondary legislation and monitors the activities carried out by banking and financial institutions, also in relation to the payments system and the overall regulatory supervision.

The Bank of Italy has also powers of inspection and sanctioning powers vis-à-vis the banks and the financial intermediaries.

In addition to the above, Italian banks qualifying as significant institutions are also directly subject to the prudential supervision of the European Central Bank (ECB), which is also entrusted with both hard and soft regulatory powers, in accordance with the overall European framework.

The Commissione Nazionale per le Società e la Borsa (CONSOB) is the Italian government authority responsible for regulating the Italian securities market. More precisely, CONSOB is entrusted with supervision on transparency and correctness of regulated entities, including banks and financial intermediaries providing investment services and other financial activities. This authority also regulates, inter alia, the solicitation of investment (ie public offers) and the marketing of financial instruments, including units of collective investment funds. For the purposes of its supervisory competence, CONSOB also has powers of inspection and sanctioning powers vis-à-vis the banks and the financial intermediaries.

What are the authorization requirements and process?

The authorization requirements and processes applicable in Italy depend on the type of intermediary which is involved (i.e. mainly a bank, an institution, an asset management company or a financial intermediary).

Generally speaking, in order to be entitled to perform banking or financial activities in Italy, each type of intermediary shall submit to the Bank of Italy a set of documents describing, inter alia, the activity to be performed and confirming compliance with each of the requisite legal requirements in order to perform such activities. The main documents to be prepared are an organizational structure report aimed at describing the internal organization and main procedures that the applicant is setting up in view of the authorization, and a business plan. The applicant institution shall also be able to demonstrate the possession of the relevant minimum own capital requirements, which differ depending on the type of intermediary.

The application includes, inter alia, documents confirming compliance with certain integrity, professionalism and independency requirements by the stakeholders and their senior management.

In this context, the supervisory authorities shall assess within a certain timeframe whether the applicant meets the required conditions. This term may be suspended if the authority requires clarifications. With respect to some significant banks the authorisation is formally granted by the ECB on the basis of the assessment made by the Bank of Italy.

At the end of the authorization processes, if successful, the banks/financial intermediaries/other supervised companies or institutions are enrolled in the relevant sections of the Bank of Italy Registers.
In relation to the fees associated with the incorporation and authorization of banks and financial intermediaries, there are no fees for the enrolment on any register of the Bank of Italy, however, certain fees are requested by CONSOB (by way of supervisory contribution).

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**What are the main ongoing compliance requirements?**

Certain conditions, requirements and thresholds (eg financial resources, compliance measures and adequate internal organization, policies and procedures, integrity, professionalism and independency requirements of the senior management) must be met in order to preserve the authorized status of the bank or financial intermediary. Failure to comply with such requirements can result in sanctions for intermediaries or banks and/or regulated entities, and in the revocation of the authorization granted.

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**What are the penalties for failure to be authorized?**

The provision of banking and/or financial activities in Italy vis-à-vis the public, without being authorized, triggers criminal sanctions (in the form of a financial penalty and/or imprisonment).

In addition (based on a number of Italian court judgements) loans granted by an entity which is not duly authorized will be null and void.

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**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

In general terms, the performance in Italy of one or more of the following financial activities requires an authorization:

- savings collection;
- payment and e-money services;
- the provision of investment services;
- granting financing in any form vis-à-vis the public (ie to third parties on a professional basis) (this activity includes the granting of loans, including the issue of guarantees replacing the credit and guarantee commitments, financial leasing, the purchase of receivables for valuable consideration, consumer credit, mortgage credit, loans backed by pledges, the issue of guarantees, the opening of a documentary credit facility, the acceptance, endorsement or commitment to grant a facility, as well as any other form of issuing guarantees and credit commitments); and
- collective asset management activities.

**Consumer credit**

The Consolidated Banking Act defines a consumer credit agreement as a contract by which the lender grants or undertakes to grant credit to a consumer in the form of a deferred payment, loan or other similar financing, also in relation to real estate consumer credit. In this context, pursuant to the Consolidated Banking Act, 'consumer' shall mean a natural person acting for purposes unrelated to a business or professional activity (if any) carried out by the same. Such definition includes all financings granted by professionals (banks or authorized intermediaries) vis-à-vis consumers. Specific transparency and disclosure obligations vis-à-vis consumers are provided for by the Consolidated Banking Act and by the Transparency Provisions. The Transparency Provisions have been amended in order to, inter alia, introduce product oversight and governance requirements for retail banking products, including consumer credit. As a consequence credit institutions shall now make sure to design and bring to the market products with features, charges and risks, that are appropriate for the interests, objectives and characteristics of a pre identified target clientele (so called "target market"). The Consolidated Banking Act also lists a set of exclusions, in relation to which the consumer credit regime shall not apply.
Are there any possible exemptions?

In relation to the possible authorization exemptions, in general terms, the above-mentioned activities do not trigger authorization requirements and can be freely exercisable if they are not performed vis-à-vis the public.

For instance, activities carried out exclusively vis-à-vis the group to which the intermediary belongs, upon certain conditions, do not fall within the scope of activity requiring authorization.

Moreover, activities carried out on an occasional basis, without any stable organization and continuity, do not fall within the definition of activities performed on a ‘professional basis’ and, therefore, are not required to be authorized.

However, according to Italian case law, the granting of one loan can fall within the scope of authorized activity if the lender has a framework in place which presumes the potential continuation of the relevant activity.

Without prejudice to the above, certain specific exemptions are provided for with regard to consumer credit activities.

Also in relation to other type of intermediaries, upon certain conditions, some regulatory exemptions could be invoked, provided that such exemptions widely reflect those already provided at the European level.

As regards the provision of payment services, it has to be considered that, after the implementation of Directive 2015/2366/EU (PSD2), operators willing to invoke the so called “limited network exemption” or the so called “electronic communication exclusion” shall submit a notification to the Bank of Italy – should some volumes and thresholds be exceeded – are enrolled in a separate section of the register as “exempted entities” and are subject to an annual assessment.

Do any exchange controls or other restrictions on payments apply?

In Italy there are no exchange controls. Italian residents may hold, within and outside Italy, foreign currency and foreign securities of any kind and non-residents may export cash and/or securities, in both foreign currency and euro and are entitled to invest in Italian securities provided that when the total amount of the value to be transferred is more than €10,000, reporting and record-keeping requirements are complied with. Entering or leaving the EU with €10,000 or more in cash must also be declared to customs.

Certain additional procedural requirements are also imposed for tax reasons.

In Italy, payments in cash, or made with bank or postal deposit savings passbooks, or by way of debt securities in bearer form both in euro or in a foreign currency must not exceed €2,000. Starting from 1 January 2022 such limit will be reduced to €1,000.

The limit fixed for money transfers as well as bank or postal check books without the identification of the beneficiary is €1,000.

What are the rules around financial promotions?

The rules around financial promotion differ depending on the object of the promotional/offering activity.

As regards the promotion of banking activities/financial services and products in places other than the registered office or the branches of the bank (ie ‘door-to-door offer’), banks may make use of their employees and financial salesmen (agenti), other banks and investment firms and the relevant salesmen, insurance companies and the relevant agents, and financial intermediaries. Certain particular transparency requirements apply in case of door-to-door promotion and placement of banking services/financial activities and products.

Certain other specific transparency rules apply to promotion of banking activities/financial services and products by means of distance marketing techniques.

The relevant rules – both relating to door-to-door promotion of banking activities/financial services and products and to promotion of banking activities/financial services and products by means of distance marketing techniques – are provided for by the Consolidated Banking Act, the Consolidated Financial Act and the relevant implementing provisions.
With reference to promotion/offer of financial instruments/investment services, for ‘door-to-door offers’ – meaning the promotion and the placement with the public of financial instruments and/or investment services and activities in a place other than the registered office of the issuer, the offeror, the seller of the services or the provider, as the case may be, the person in charge of carrying out the promotion and the placement of such financial instrument(s) or service(s) will be subject to specific rules. The intermediaries may also make use of financial salesmen (consulente finanziario abilitato all’offerta fuori sede), ie individuals who, acting as tied agents under the MiFID II, carry out the door-to-door sales of financial instruments/investment services. Financial salesmen must be registered in a specific register kept in accordance with Italian financial law.

Intermediaries, including banks, may engage in door-to-door selling of their own investment services and activities. Where such selling involves services and activities provided by other intermediaries, the offering intermediary must be authorized to perform the services of:

- subscription and/or placement with firm commitment underwriting or standby commitments to issuers; or
- placement without firm or standby commitment to issuers.

In case of door-to-door offers of financial instruments or investment services, any recipient of such instrument or service will have a right of withdrawal within a specific term.

For door-to-door selling of their own investment services and activities by means of distance marketing techniques, the use of financial salesmen is not required. Moreover, the right of withdrawal will be governed by the general provisions set forth by the applicable rules and regulations, as applicable (Consumers’ Code etc).

The above-mentioned requirements relating to door-to-door offer of financial instruments/investment services and the door-to-door offer of financial instruments/investment services by means of distance marketing techniques do not apply in the case that the offering activity is carried out vis-à-vis professional customers nor in case the offering consists only of own financial instruments and is targeted to executives, employees and other affiliates of the relevant issuer.

In addition, certain specific rules will apply to ‘public offering of securities’.

‘Public offering of securities’ means every communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe for those securities. This definition also applies to the placing of securities through financial intermediaries.

The legislation provides for specific requirements applicable to ‘public offerings of securities’; in particular, any public offering is subject to the publication of a prospectus by the person making the offer, such publication being subject, in turn, to the prior authorization of CONSOB (which, inter alia, is the authority in charge of the supervision of public offerings of securities in Italy). The prospectus shall be drafted in compliance with the provision of the Prospectus Regulation and of its relevant implementing provisions.

Certain exceptions to the obligations relating to ‘public offering of securities’ are provided for by the law.

Entity establishment

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

In general terms, the performance of banking/financial activities in Italy is mainly reserved to duly licensed entities, subject both to initial authorization requirements and to ongoing controls and supervision. In this context, some of the authorization procedures set forth under the Italian regulatory framework expressly require certain types of legal entities or corporate forms, modulated on the basis of the activities to be performed and on the related legal and regulatory safeguards to be adopted (eg with reference to sound and prudent management requirements, the relevant capital requirements and liability issues).
The most common type of legal entities involved are limited companies, especially companies limited by shares (società per azioni) or limited liability companies (società a responsabilità limitata), which are generally characterized by separate legal personality and limited liability of the members.

Please note that, in any case, special organizational and governance rules are usually imposed on supervised intermediaries, regardless of the specific legal regime commonly applicable to the adopted corporation. Particular provisions are also set forth in relation to qualifying holdings which:

- an intermediary is entitled to acquire in other entities; and
- other entities are entitled to acquire in an intermediary.

Notwithstanding the above, upon certain conditions, intermediaries' shares can be offered to the public or admitted to trading on a regulated market.

**Funds**

Italian investment funds can be established by contract or as a corporate entity.

In the case of a fund established by contract, a management company is needed and such entity, usually a Società di Gestione del Risparmio (SGR), shall be a company limited by shares. In the case of corporate funds (Società di Investimento a Capitale Variabile (SICAV) or Società di Investimento a Capitale Fisso (SICAF), based on the open-ended or closed-ended nature of the fund), the vehicle could be both self-managed or externally managed by a management company, qualifying as a company limited by shares.

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**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes.

A company can conduct lending business in Italy through an establishment (also known as a ‘branch’).

Companies having an Italian establishment need to follow a notification procedure before starting their operations in Italy.

As regards funds, following the Undertakings for Collective Investment in Transferable Securities (UCITS) directives and Alternative Investment Fund Managers (AIFM) directive implementation, EU asset management companies can carry out their activity in Italy on the basis of ‘passports’. In particular, the EU asset management companies can set up and manage Italian alternative investment funds both under an establishment regime and under freedom to provide service regime and can offer in Italy their funds on a cross-border basis.

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**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Peer-to-peer funding platforms and marketplace lending**

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved, provided that CONSOB has recently conducted a set of studies on the matter, trying to outline a more precise framework for this phenomenon. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based
structure;

• applying technology to leverage and optimize the lending platform and user experience; and
• connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P)-type structures often operated through an electronic platform provider as well as crowdfunding and also direct to retail financing mechanisms.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Italian marketplace lending is at an early stage of development but the number of participants and transactions is increasing at a rapid rate. Issues for such lenders may relate to funding structures and the regulatory aspects of marketplace lending. For more information, see FinTech products and uses – particular rules.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record, for example, relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced,
more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

Recent regulatory changes introduced the possibility for the execution of smart contracts to have the same evidentiary value of written contracts under specific conditions and technical standards that needs still to be approved. Once approved, such a change might represent a significant improvement since smart contracts might be more easily used in the financial services sector.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether, based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Furthermore, because of these different features, it is not only the Italian banks and financial institutions that are interested in this new technology, but also the insurance, digital payments, Industry 4.0, the Internet of Things (IoT), health, retail and public sectors.

As a general remark, it is not quite clear which Italian regulatory reference framework can be (and is) used for managing impacts connected to the crypto-currencies sector; moreover, important proposals for action, such as the adoption of decrees implementing EU provisions, are on the table of the Italian Parliament and are expected to be adopted and implemented in the next future.

Having this said, at the current state of affairs, a first step towards the regulation of the aforesaid sector has been made with reference to the anti-money laundering regulations. With the implementation of the Fourth and Fifth AML Directive providers engaged in exchange services between virtual currencies and fiat currencies and custodian wallet providers have been expressly included within the scope of the obliged entities subject to the requirements and obligations of the AML and CTF regulations.

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. The expression 'Initial Coin Offering' was initially used in the relevant market with reference to the issue of crypto-currencies (e.g., Bitcoin, Ethereum); as of today, such expression is used to identify any offering of tokens which do not necessarily represent a crypto-currency but, however, embed various rights and can be purchased against payment either in fiat currency or crypto-currency. ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. In general terms, most ICOs are issued for an activity/project. Tokens may be issued by companies, natural persons or networks of product developers. The company's business activity is often merely in the phase of being planned (more or less organised start-ups), and the production of goods/services is scheduled to start after the end of funding.

It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

ICOs are substantially similar to an Initial Public Offering as long as both the offerings aim at raising capital from the public made up of a potentially undetermined number of investors, involving a set of activities aimed at promoting/advertising the offering itself. Compared to conventional offerings of financial instruments, ICOs are characterised by the following elements:

- use of blockchain technology, which allows to disintermediate the typical capital markets infrastructure (e.g., custodian banks,
underwriters, secondary markets);

- the means of payment used for the transaction settlement, as payments for purchasing tokens are made in crypto-currencies (e.g., Ethereum, Bitcoin) instead of fiat currency;

- they are advertised and promoted via the World Wide Web, which allows promotion and funding at a cross-border level, with no territorial constraints either for the issuer or the promoter;

- the publication of a so-called ‘white paper’ in place of a prospectus, describing the main characteristics of the investment scheme and the object of the offering.

Due to their characteristics, some types of token may qualify as financial instruments or, as financial products (investment tokens or security-like tokens). Other tokens present a variable mix of characteristics and are therefore called ‘hybrid tokens’; these are the most difficult to discuss and qualify in the light of the current regulatory framework. In particular, this last set of tokens may have a remarkable financial content, in addition to being placed to retail investors via public offerings.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

Artificial intelligence and robo advisory systems

The system known as ‘robo advisors’, or automated financial advice tools, are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. In general, robo advisors or automated financial advice (and optimization) tools are digital/mobile asset management and financial advice platforms, which process data around specified parameters for a variety of financial assets and activities and/or (personal) finances.

Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

In terms of different market sectors, AI brings significant value to financial operations, where both the risk mitigation as well as customer service could be supported. Italian AI is a rapidly growing sector. With reference to the Italian market, it is estimated that in 2019 the assets managed by ‘robo advisors’ exceeded $400 million (with an average assets approximately equal to $12,000 per client), while the average growth rate forecast between the 2019 and 2023 stands at a total of around 51%.

Data analysis and cloud computing

WHAT IS CLOUD COMPUTING?

Cloud computing is a method for delivering scalable and flexible information technology (IT) services in which users can retrieve resources from the internet/intranet through private or public web-based tools and applications, rather than hosting software locally within their
own organization. Within the broad ‘cloud’ concept three main service models can be identified:

- Software as a service (SaaS) involves providing access to and use of, an end user software application, such as e-mail or a word processor, through a pay-as-you-go or on-demand model.
- Platform as a service (PaaS) involves providing access to and use of tools for the development and deployment of custom applications, for example, certain mobile applications.
- Infrastructure as a service (IaaS) involves providing access to and use of computing resources including servers, networking, storage, and data center space on a pay-per-use basis.

Depending on the degree of privacy of the resources and service delivery mechanisms, businesses can employ cloud computing in different ways. Some users maintain all apps and data on the cloud, while others use a hybrid model, keeping certain apps and data on private servers and others on the cloud.

**WHAT ARE THE ADVANTAGES OF CLOUD COMPUTING FOR FINTECH FIRMS?**

The rise of cloud-based solutions offers FinTech companies a number of potential benefits allowing them to speed-up business processes while reducing costs. As an example, cloud computing could:

- assist in automating audit and verification processes thereby allowing FinTech engineers to work on product enhancement;
- allow maintenance of performance levels even during peak hours or end of month queues, by giving access to high-performance servers and data storage;
- help make the production cycle continuous by providing access to data 24/7, thereby reducing time-to-market of a product/solution; and
- help create an enhanced setup for disaster recovery.

In exploring the potential benefits of cloud computing, attention should be paid to ensure full compliance of each solution with the applicable law, even at local level.

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**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

In relation to the performance of banking, financial or payment services, the main Italian supervisory authorities are:

- the Bank of Italy, which is the central bank of Italy and is entrusted with the overall regulatory supervision of banks and other financial intermediaries, including payment services providers and e-money issuers; and
- the CONSOB, which is the Italian government authority responsible for regulating the Italian securities market as well as the provision and marketing of investment services.

CONSOB is entrusted with supervision on transparency and correctness of regulated entities, including banks and financial intermediaries providing investment services and monitoring compliance with the rules of conduct generally imposed on such intermediaries.

Additional authorities also operate, in relation to specific sectors (eg insurance) or in connection with specific issues (eg competition and data protection).

**GENERAL**

The provision of banking, financial and payment services in Italy is reserved to authorized intermediaries. A person must not carry on a regulated activity in Italy unless authorized or exempt.

Consequently, where FinTech products and applications involve financial activities falling within the scope of the required regulatory authorizations, the firms providing such products and applications, if not otherwise exempt, must be authorized/passported, as the case
Following a public debate involving market operators and based on a document for discussion CONSOB recently published a report on the initial offers and exchanges of crypto-activities. Pending the establishment of a shared European regulatory framework on crypto-assets and, in particular, on their possible qualification as securities, CONSOB's intention was to start a debate at national level on initial coin offerings (ICOs) and crypto-assets exchanges, in connection with the recent spread of ICOs and therefore, of crypto-assets invested in by Italian investors.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**ELECTRONIC MONEY (E-MONEY)**

Reference shall be made to the provisions of the e-money directive No. 2009/110/EC (EMD) and to its national implementing measures, which include the Consolidated Banking Act and Legislative Decree No. 45, 16 April 2012, containing the EMD's implementing decree, both as amended from time to time. Moreover, for a complete understanding of the applicable legal and regulatory framework, also the rules regulating the provision of payment services shall be considered, as well as the Bank of Italy secondary level provisions.

E-money is defined as the electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person other than the e-money issuer and include pre-paid cards and electronic pre-paid accounts for use online.

All providers performing payment services or e-money related activities must be authorized by, or passported with, the Bank of Italy, although, based on the specific functioning mechanism, the management of electronic payment platforms could qualify as a reserved activity, subject to regulations governing payment service providers and e-money issuers, or fall within one of the possible exemptions (eg if the firm qualifies as a mere technical service provider supporting the provision of the relevant services without any involvement in their offering or performance).

**PEER-TO-PEER LENDING**

Peer-to-peer lending activities (also 'social lending' or 'lending based crowdfunding') are defined, under the Italian regulatory framework, as 'the mechanism through which a plurality of borrowers could demand to a plurality of potential lenders, by means of online platforms, refundable funds for personal use or to fund a project'.

Based on the similarity of such activities with those relating to the public savings collection and considering that the latter, in accordance with the Consolidated Banking Act, are exclusively reserved to duly authorized credit institutions, since November 2016, the Bank of Italy has regulated social lending by a regulation governing the performance of collection activities carried out by subjects other than banks. The relevant provisions mainly clarify the conditions to be complied with in order to avoid a qualification of social lending services as reserved savings collection activities.

Bank of Italy's regulation refers both to the managers of social lending platforms and to the subjects who collect or lend funds through such platforms and is generally aimed at preventing non-banking entities from raising significant amounts of funds vis-à-vis an indefinite number of borrowers. In this sense, managers and collectors are, in any case, precluded from collecting demand deposits and from carrying out other forms of collection whatsoever involving the issuance or management of payment instruments having generalized usability. No limits are imposed on banks in carrying out social lending activities through online portals.

The Bank of Italy does not have investigation or sanctioning powers on non-banks entities providing collection activities. Any infringement of the aforesaid provisions is governed by criminal law.

A special regime for the collection of risk capital via online portals (equity crowdfunding) is regulated by the Italian securities law (in particular by the Crowdfunding Regulation (as amended by CONSOB resolution No. 21110 dated 10 October 2019), adopted by CONSOB pursuant to articles 50- quinquies and 100- ter of the Consolidated Financial Act). In equity crowdfunding, the securities respectively sold are issued by Italian innovative startups and small-to-medium-size companies or by certain undertakings for collective investments investing in those kind of companies. The managers of such portals shall comply with a set of requirements, and in order to be entitled to operate are then enrolled in a specific register kept by CONSOB.

Following recent amendments to the Consolidated Financial Act and the Crowdfunding Regulation, the Italian regulation also introduced the possibility, within certain limits, for the aforesaid entities to collect of bonds and other debt financial instruments through such online portals (debt crowdfunding).
The other possible forms of crowdfunding are not formally regulated and may be included – depending on the specific features and structures adopted – in other forms of financial activity, such as those relating to the granting of loans (whose performance is reserved to duly authorized financial intermediaries).

**Regulation of payment services**

Reference shall be made to the provisions of the PSD2 and to its national implementing measures, which include the Consolidated Banking Act, and Legislative Decree No. 11, 27 January 2010, containing the PSD2's implementing decree (PS Decree), both as amended from time to time, as well as Bank of Italy secondary level provisions.

All providers performing payments services related activities shall be authorized by (or passported with) by the Bank of Italy.

In providing and marketing their services, payment services providers must also comply with the transparency and disclosure requirements set forth in the Transparency Provisions.

**Application of data protection and consumer laws**

The Italian Data Protection Code (Legislative Decree No. 193/2003) applies to the processing of personal data, including data held abroad, if the processing is performed by:

- an Italian or European Union company with a branch/stable organization in Italy;
- an entity established in the territory of a country outside the European Union, where said entity makes use in connection with the processing of equipment, whether electronic or otherwise, situated in the Italian territory, unless such equipment is used only for purposes of transit through the territory of the European Union; and
- a non-European Union controller processing data through a branch/stable organization in Italy.

Data processing under the Italian legislation may imply certain notification and compliance obligations and can give rise to privacy issues such as:

- whether the data is used appropriately;
- whether the collection of data is carried out in an appropriate manner;
- whether the data is disclosed only where disclosure is appropriate;
- whether the data is stored and transmitted safely;
- how long the data will be retained for;
- the circumstances under which the data subject can access and correct the data; and
- whether the data subject is sufficiently and appropriately informed about these matters.

The European General Data Protection Regulation (GDPR) will officially replace some of the provisions of the Italian Data Protection Code from 25 May 2018, but its principles are already being enacted in the Measures issued by the Italian Data Protection Authority. The GDPR is more prescriptive and restrictive and includes mandatory notifications where a breach occurs and provide for severe monetary sanctions in case of breach.

The Italian Consumer Code (Legislative Decree No. 206/2005) applies to any service offered to natural persons acting for purposes outside their trade, craft, business or profession. It includes rules relating to matters such as unfair commercial practices and unfair terms. In order to ensure compliance with the Italian Consumer Code, Fintech companies may consider the implementation of solutions aimed at monitoring and analyzing customer services, mitigating fraud and abuse, and implementing fair lending systems.

**Money laundering regulations**

The Italian rules governing the prevention of the use of the financial system for money laundering (AML) and/or terrorist financing (CTF) purposes are mainly contained in Legislative Decrees No. 231 of 21 November 2007 (AML Decree), and No. 109 of 22 June 2007, which implement the Fourth AML Directive) and Fifth AML Directives. Additional secondary level provisions which complete the new regulatory
framework introduced by the Fourth and Fifth AML Directives have been issued by the Bank of Italy.

In general terms, the Central Information Unit (Unità di Informazione Finanziaria), established within the Bank of Italy, is empowered with supervision and monitoring powers on AML and CTF issues. The overall prevention system:

- is based on the collaboration and coordination between each of the operators and the administrative and investigation authorities;
- is regulated according to the risks involved; and
- requires the operators to comply with a series informative and record-keeping obligations.

FinTech services and activities, where relevant in light of the above, are subject to AML and CTF provisions, especially when involving activities considered as high money-laundering risks. Furthermore, with the implementation of the Fourth and Fifth AML Directives, the Italian legislator has expressly included “crypto currency operators” and “custodian wallet providers” within the category of the “other non-financial operators” subject to the provisions of the AML Decree. Crypto currency operators are defined as “any natural or legal person which provides third parties, in a professional capacity, with services that are functional to the use, the exchange, the custody and storage of virtual currencies and their conversion from, or into, currency of legal tender”, or in digital representations of value, including those convertible in other virtual currencies as well as issuing, offering, transfer and clearing any other service instrumental to the acquisition, negotiation or intermediation in the exchange of the virtual currencies”. Custodian wallet providers are, in turn, defined as “any natural person or entity that provides services to safeguard private cryptographic keys on behalf of its customers, to hold, store and transfer virtual currencies”.

It should be noted that, according to the aforesaid AML regulations, crypto-currencies operators and custodian wallet providers are, as of today, subject to the AML obligations to the extent that their operations include the performance of the activity of cryptographic storage or of conversion of virtual currencies from, or into, currency of legal tender.

In addition to the above, FinTech providers qualifying as banking or financial institutions or payment services providers shall also comply with the customer due diligence and on organisational requirements set forth in the secondary level regulations of the Bank of Italy.

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**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development.

**CROWDFUNDING**

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

Below are the most common models of crowdfunding:

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.
- Donation crowdfunding involves NGO and non-profit associations in relation to the funding of humanitarian projects and nonprofit projects.
- Hybrid crowdfunding is a combination of the above.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.
ACCELERATORS

There are a growing number of incubators or accelerators in the Italian market which offer support, facilities and funding for startups, often in return for an equity stake, such as iSTARTER.

Venture capital and debt

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions. Research suggest that there are more than 15 asset managers active in venture capital in Italy with more than 60 funds under management.

Warehouse and platform funding

Warehouse financing and platform financing may be suitable for FinTech companies depending on the type of business and assets.

Senior bank debt and capital markets funding

Senior bank debt

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

Capital markets funding

In Italy both debt and equity capital markets are accessible to FinTech businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) is a possible funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the Milan Stock Exchange. The Milan Stock Exchange’s Alternative Investment Market (AIM) in particular caters for small, growth-orientated companies.

Issuance of bonds is an alternative funding structure for FinTech businesses.

Convertible bonds/loan notes

Convertible bonds or loan notes may also represent a funding tool for FinTech businesses, being essentially a hybrid between debt and equity. Convertible instruments begin as a bond accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

Securitisation transactions

An additional funding tool for the FinTech companies may be the realization of a securitisation transaction. In particular, it is possible to securitize the loans granted by FinTech platforms and have access to the funds of the investors on the debt capital markets.

Incentives and reliefs

Innovative startups

Italian tax law establishes a set of tax incentives to Italian companies qualifying as so-called 'innovative' startups. The favourable regime is available to Italian and European Union/European Employment Strategy companies having a branch in Italy, provided they meet a set of requirements. Among others these are as follows:

- The company’s core business should consist of the development, production and commercialization of innovative goods or services of high technological value.
- The company should have been set up for no longer than 60 months.
The company's turnover should not exceed €5 million.

The company shall not distribute profits.

Companies and individuals investing directly or indirectly in qualified innovative startups may benefit from significant tax reliefs up to 30% of the invested amount, subject to a minimum holding period of three years.

ALLOWANCE FOR CORPORATE EQUITY

Italian companies and Italian permanent establishments (PEs) of foreign enterprises may benefit from Italian notional interest deduction (NID) (so-called Allowance for Corporate Equity or ACE). The ACE benefit entails a notional deduction from the corporate income taxable base corresponding to the net increase in the 'new equity' injected in the entity after 2010, multiplied by a rate annually determined (1.3% for financial year 2019 and thereafter as set by the Budget Law for 2020). The qualifying equity increases may include equity contributions, retained earnings (with the exception of profits allocated to a non-disposable reserve) and the waiver of shareholder credit.

RESEARCH, DEVELOPMENT AND INNOVATION TAX CREDIT ("RDI")

From financial year 2020, Italian companies and Italian PEs of non-resident companies carrying out qualifying RDI activities (i.e. R&D expenses and technological innovation costs, together RDI) can benefit from a tax credit computed as a percentage of each specific RDI expenditures (e.g. 12% of the costs falling in the base of R&D computation, net of external contributions, up to the amount of Euro 3 Mio per 12 months; 6% of the costs qualified as technological innovation expenses, net of external contributions, up to Euro 1.5 per 12 months; 10% of the costs qualified as technological innovation expenses for new products/processes, net of external contributions, up to Euro 1.5 per 12 months; 6% of the design costs, net of external contributions, up to Euro 1.5 per 12 months). The tax credit can be used to offset other taxes due, in three equal instalments. Other fulfilments (e.g. formal communication to the Ministry of Economic Development) are mandatory required before the tax credit is used.

PATENT BOX

The patent box regime is a tax bonus introduced in order to improve the development of intellectual property, granting tax benefits to resident and non-resident taxpayers carrying out R&D activities, consisting of partial tax deduction (50%) from corporate income tax for income arising from direct use or licensing of qualified intangible assets (not including commercial trademarks).

WITHHOLDING TAX EXEMPTION ON INTEREST PAYMENTS

Italian tax law provides for an exemption from withholding tax on interest payments on medium-long term loans granted to Italian-resident borrowers by European Union foreign institutional investors (e.g. banks, insurance companies) and certain approved institutional investors. In order to benefit from the exemption, foreign lenders should comply with Italian law on the exercise of lending activity (to the extent that they operate vis-à-vis the public). The withholding tax exemption would apply to the extent the borrower performs business activities, expressly including holding companies.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio.

The most common ways of selling loans are:

- **Assignment of contract** – An assignment of contract is a full legal transfer of the party’s contractual rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results the transferee becomes party to the loan agreement, with the transferee assuming all the rights and obligations arising under the agreement and the transferee and the transferor being released from its obligations.
Assignment of receivables – An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor but notice to the debtor is generally required in order to make such transfer opposable to vis-à-vis the relevant debtor. The assignment will result in the assignee becoming the legal owner of the receivables and being entitled to receive the relevant payments.

In the case of transfer of contracts/receivables as a pool and provided that the transferee/assignee meets certain requirements, the assignment may be made under Article 58 of the Consolidated Banking Act, so that the notice of the assignment can be performed with a publication on the Official Gazette and in the competent register of the companies registry.

Depending on the specific needs of the transaction and taking into account the requirements of the relevant investors, the receivables can be assigned to a securitization vehicle in accordance with the Italian Securitization Law, so that the purchase price of the receivables is paid by the securitization vehicle which is funded through the issuance of asset-backed securities notes. The assignment of the receivables to the securitization vehicle is made as a true sale.

Loan transfers (including in bonis or non-performing loans) are commonly documented as a bespoke sale and purchase agreement. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercised. Some of the key considerations include:

- **authorization requirements** – lending activity (including the purchase of receivables) is a reserved activity and the transferee/assignee must be duly authorized (in case the investor is not authorized to carry out such activities in Italy, a securitization structure can be used); in relation to the assignment/sub-participation schemes, it is noteworthy to highlight the strict approach very recently locally adopted by the Italian Supreme Cassation Court (criminal law division); in the context of a proceeding against a foreign bank accused of providing lending activity in Italy without authorization, the Court has in fact identified a set of symptomatic elements based on which it could be concluded that a fictitious structure has been put in place with the exclusive aim of concealing the lending activity carried out by a non-authorized entity. These symptomatic elements include, inter alia: (i) allocation of the default risk also on the unauthorized entity and not only on the authorized entity; (ii) independent credit risk assessment formulated by the foreign non-authorized entity; (iii) awareness of disclosure to the borrower of the agreements concluded between the authorized and the unauthorized entities; (iv) possibility, for the foreign non-authorized entity, to interfere in the implementation of the relationship with the borrower; (v) greater commitment of the foreign unauthorized entity in terms of exposure with the borrower;

- **tax aspects** – the tax implication of the assignment/transfer must be evaluated on a case by case basis;

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;

- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;

- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;

- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms;

- **consent and notification** – whether a transfer requires the consent or notification of any other parties (as indicated above, notice of the assignment (or, in the event of an assignment as a pool and provided that Article 58 of the Consolidated Banking Act applies, publication on the Official Gazette and in the competent register of the companies house) is generally required); and

- **acknowledgment of security** – an acknowledgment of the security is generally needed (depending on the kind of security, notarization and registration of the acknowledgement deed(s) may be needed).
Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

ENERGY

The energy sector has a fundamental role to play in the growth of Italy's economy, both as a facilitating factor (providing a competitive supply environment whilst limiting environmental impact) and also as a growth factor itself. This is why the government has drawn up a National Energy Strategy that sets out clearly the main goals to be pursued in the coming years whilst remaining aware that we are acting in a free market context and with driving forces that cannot be controlled centrally. Sustainable growth, the main priority for both the government and the country, can be achieved only if the competitiveness of the Italian economy improves substantially, not least within the energy sector and the national electricity market. To achieve this goal, it will be essential to act on all structural factors which may enhance Italy's competitive position internationally.

INFRASTRUCTURE

The infrastructure sector in Italy is expected to have an increasingly important role in the national economy in the following years due to the effort of the Italian government to promote economic growth and modernization of the country through infrastructural investments, both public and private. In general, infrastructure is publicly owned, apart from some minor projects (touristic marinas, stadiums, management of airports, management of ports etc). Most infrastructures are now developed under public-private partnership (PPP) schemes financed through project financing investments (metro, motorways, hospitals, light rail, public offices etc).

Energy

The ownership of energy and infrastructure assets in Italy can be private or public. From the grid perspective, the National Electric Transmission Grid (RTN), with over 72,000 km of HV lines, is publicly owned but its management has been assigned to a specific private operator (TERNA). From the 'operator's' point of view, the generation, distribution and supply services has been privatized by the Bersani Decree in 1999 – which has liberalized the energy market by the creation of free competition. The distribution of energy is granted under a concession regime to certain operators while the supply activity of energy is freely carried out by other companies in a competitive regime. All the activities are carried out under the vigilance of the energy authorities. The main public bodies having responsibility for the regulation of the energy sector in Italy are the GSE (Gestore Servizi Energetici) and ARERA (Autorità di Regolazione per Reti e Ambiente).

Transport infrastructure

HEAVY RAIL

The rail market in Italy is dominated by the national railway company Gruppo Ferrovie dello Stato Italiane, a publicly owned company which includes the national network owner RFI Rete Ferroviaria Italiana. With regard to high speed trains, a new operator, Nuovo Trasporto Viaggiatori S.p.A., has entered the market offering high speed train transportation. There are no signs of the market opening up to more competitors on high speed transportation.

LIGHT RAIL, PUBLIC BUSES

Light rail assets (such as trams and associated track) are generally owned by local public sector promoting bodies. As for metro lines, two important projects (Milan Line M 4 and Milan Line M5) have been developed under a PPP scheme. Similarly to light rail, certain regional authorities have tendered concession agreements for the renewal, maintenance and operation of public buses for regional public transportation.

ROADS, BRIDGES AND TUNNELS

A government entity (ANAS) operates, maintains and improves the motorways and major state roads in Italy. ANAS is regulated by the Ministry of Infrastructures and Transport and receives funding from the government for investment in the strategic road network.
(including additional road capacity). Local roads in Italy are the responsibility of local authorities. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. In certain cases, the private sector is awarded the design, build, financing, operation and maintenance of motorway sections (in particular the BreBeMi motorway where traffic risk is mainly with the private sector).

AVIATION

Aviation in Italy is (for the most part) privatized. In relation to airport infrastructure, there are a number of ownership structures in the Italian market, including private ownership, local government ownership and various forms of public-private ownership. All models are heavily regulated by government and ENAC, the Italian Civil Aviation Authority.

PORTS

The Italian ports sector comprises a variety of company and municipal ports, all operating on commercial principles, independently of government and largely without public subsidy. The private sector operates the vast majority of the Italian major ports.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, NURSING HOMES ETC)

Typically, these are owned by the public sector. Social infrastructure assets in Italy have often been directly financed by the government, save for hospitals and nursing homes where in the recent years the PPP model has been at the base of the most successful projects in the sector or where (especially for nursing homes) investment funds are investing using private capital.

Education

The ownership of a school's infrastructure depends upon the categorization of the school itself. For example, in the case of a local authority maintained school, the school and playing fields will be owned by the local authority, whereas an academy school (which receives funding directly from the government) may lease land from a local authority. In the case of private schools, these are owned and financed by private institutions although it is not uncommon that such private schools receive at least some funding from the government.

Hospitals and nursing homes

Ownership of hospitals and nursing homes in Italy is often vested in various public sector bodies managed and financed at regional level and operating within the National Health Service. There are also several private structures which can also provide health services under specific arrangements with the National Health Service. In recent years, most of the new hospitals especially in the northern regions have been developed under PPP schemes and investment funds are investing in public and private healthcare facilities. It is important to point out that the construction of health and social care facilities and the carrying out of the relevant activities are heavily regulated both at national and regional level.

DEFENSE

Typically, defense assets are owned by the public sector.

WASTE

Waste management in Italy is managed at a municipal level in accordance with national legislation, and differs widely from area to area. Companies in the waste management sector provide services on a continuing basis, with prices set through service contracts. By law such prices are required to cover the full cost of operations and investments, based on the principle of full cost recovery. To date, most players in the waste management sector are public-private partnerships or private companies.

WATER

Water and wastewater (sewage) services in Italy are delivered by public sector companies (water companies) which use the relevant public infrastructure assets. In certain cases, such companies are grouped together to form an ATO (Optimized Territorial Area) so as to manage the relevant services in a more efficient manner by way of outsourcing to private companies.

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Are there special rules for investing in energy and infrastructure?

**Energy**

There are no particular limitations to the investment by foreign entities in Italian energy assets. However, the supply, generation, transmission and distribution of energy are heavily regulated sectors. Permitting, concessions and subsidies regimes evolve quickly and any investors will need to have a good understanding of both the current framework and the potential directions in which the legal framework and the market may move.

It is also to be considered whether the acquisition of any interests in the energy sector would cause any issues with any concessions, licenses, permits or agreements with public authorities.

**Infrastructure**

There are no particular limitations to the investments by European entities in Italian infrastructure assets. Potential investors coming from outside the EU may face more difficulties and barriers to entry due to less harmonized legislative systems.

**What is the applicable procurement process?**

**Energy**

The procurement process for the achievement of the energy efficiency targets requires, as a prerequisite, collaboration and coordinated action between the State and local governments. This has resulted distribution of the 2020 targets on renewable energy and energy efficiency (known as ‘Burden Sharing’) which assigns to the State and each local government a corresponding objective in terms of sharing energy consumption through renewable sources. Each region can, based on the characteristics of its territory and the general nature of its consumption, operate at the most appropriate levels of renewable energy consumption. Potential savings are very broad but will require the careful action of local government, for example in the fields of local transport and mobility, public lighting, buildings and district heating. The role of regional and local authorities is also crucial for the effective simplification and harmonization of the authorization procedures.

**Infrastructure**

In general, the Code of Public Contracts provides for different public procurement procedures (eg the open procedure, the restricted procedure, the negotiated procedure and the competitive dialogue).

It must be highlighted that the open procedure consists in the following steps:

- publication of a call for tender;
- submission of offers by the bidders;
- evaluation of the offers by the Awarding Entity;
- awarding of the tender; and
- submission of the contract.

Each individual step is structured as follows.

**PUBLICATION OF THE CALL FOR TENDER**

The publication of the call for tender aims to select the subjects who meet the necessary requirements in order to enter into the agreement with the awarding entity.

**THE SUBMISSION OF THE OFFERS**
Pursuant to the Code of Public Contracts, in order to take part to the public tender procedure, the bidder has to meet the requirements stated by the call for bids.

If the bidder does not meet these requirements, it will be excluded from the tender.

As a general rule, two requirements must be met:

- **The general requirements** – These requirements are aimed at assuring that the administration will enter into the agreement with a trustworthy and reliable subject. Such requirements are defined by Article 80 of the Code of Public Contracts, which provides a list of mandatory requirements to be met by all entities taking part in a public procedure. In particular, Article 80 provides, *inter alia*, that the awarding entity cannot award the procedure to companies that have incurred breaches concerning tax payment obligations. This violation represents a cause of exclusion from the tender when the breach is considered serious (i.e., if it exceeds an amount of €10,000). Moreover, there is also the requirement that the bidder and the subcontractor should not have committed any serious professional crime.

- **The special requirements** – Such requirements relate to the experience and technical and financial capability of the bidders. Such requirements are provided by the awarding entity in the tender documentation, on the basis of the value and the nature of works, services or supplies which are subject to tender.

Moreover, in order to take part in the procedure, the bidder shall submit an offer including all the required documents by the deadline indicated in the call for tender. In order to fulfil the above-mentioned requirements, the bidder must declare, through a self-declaration (the so-called DGUE), that the business operator and its management meet all the general requirements. Any sub-contractor will also have to declare through the DGUE. If the business operator or its subcontractor do not fulfil the above-mentioned requirements they will be excluded from the tender.

In case of false self-declaration, penal and civil consequences shall be applied (e.g., exclusion from the tender; enforcement of the bid bond; warning to the Anticorruption Authority (ANAC); prosecution for the offence of false declaration of a public deed). If the ANAC believes that such declarations have been given fraudulently or with sufficiently serious negligence (considering the facts of the false declaration or false documentation), it may exclude the bidder from public tenders for a maximum of two years.

**EVALUATION OF THE OFFERS BY THE AWARDING ENTITY**

After the expiry of the deadline for the submission of the offers, the awarding entity shall proceed with the examination and evaluation of the offers received. This activity is carried out in several private sessions and it depends on the awarding criteria.

The awarding entity will be required to independently make such verifications, in relation to the accessible data, through the consultation of several databases. However, they may ask bidders to provide appropriate evidence or to carry out verifications on a sample basis.

The awarding entity may also require, *inter alia*, the criminal records and a court certificate concerning pending trials (a *Certificato del Casellario giudiziale* and *Certificato dei carichi pendenti*) and a tax certificate released by the ‘Agenzia delle Entrate’.

The awarding entity will also consult the Digital Registry held by the ANAC. This will reveal if the bidder has been excluded from public tenders (within the previous two years, starting from the registration of the fact in the Registry) as a result of false declarations, as mentioned above.

**AWARDING OF THE TENDER AND SUBMISSION OF THE CONTRACT**

If the evaluation of the requirements has a positive outcome, the awarding entity will enter into the agreement with the awardee and ask for the issuance of the performance bond.

Please note that any bidder must satisfy each general and special requirement for the entire duration of the tender procedure. Please also consider that the awarding entity should periodically verify the fulfilment of each requirement and if during the execution of the contract any such requirement is not fulfilled, the awarding entity is entitled to terminate the contract.

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**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**
The Italian energy industrial sector has been financed by various structures. Renewable energy sources have been historically financed through project financing and cash-flow based leasing agreements based on business plans reflecting the long-term life span of public subsidies. However, in the recent years the public subsidies for new energy plants have been reduced or, in certain cases, have not been renewed; the result is that the market, at least for the more technologically advanced sources such as photovoltaic, is now shifting to subsidy-free investments supported by long-term private power purchase agreements.

More recently, securitization has been used (including through synthetic transactions) to consolidate large debt portfolios both in the renewable energy sector (eg portfolios deriving from project financing transactions) and in the energy efficiency sector, where operator-owned portfolios of credit receivables and energy efficiency certificates are payable over the lifespan of the underlying agreements.

Bonds and minibonds are also commonly used in the sector.

A current market trend is the offer of mezzanine financing by financial entities or funds eager for high interest rate of return, particularly in the renewable energy sector. An operator may in fact demand mezzanine financing to release equity trapped in generation assets with stable returns and long maturity.

Also, the Italian infrastructure sector has been funded through project financing. In certain cases, traditional project financing has been subject to refinancing which has also contemplated a portion of bond financing.

**Investing**

The most commonly used forms of investments in the energy sector are funds and commercial companies (limited liability companies per shares, SPA, or simplified limited liability companies, SRL). There are significant differences between asset deals and share deals in terms of liabilities transferring to the purchaser, required consents by the authorities to the change of owner of the plant or the energy infrastructure and tax treatment of the transaction. Where possible, share deals are preferred in the energy generation sector, due to various legal and tax considerations.

In the infrastructure sector, investors mainly use special purpose vehicles in the form of commercial companies (either SPAs or SRLs) created specifically for the purposes of appropriate project management.

**Restructuring**

**Enforcement and sanctions**

*When can there be regulatory investigations?*

To safeguard the integrity of the financial system and to combat illegal practices, both the Bank of Italy and the CONSOB carry out specific controls, aimed at preventing unauthorized activities, as well as any activity involving mis-selling, money-laundering, usury, market abuse.

The investigations are carried out through the evaluation of documents and on-site inspections at intermediaries' premises aimed at checking the quality and accuracy of the data submitted and at gaining a better understanding of their organization and operations.

Moreover, regulators may require the drafting or transmission of documents, records and any other useful information.

*What regulatory penalties may apply?*

In the event that management irregularities and regulatory violations are discovered in the course of off-site reviews and on-site inspections, sanction procedures may be initiated against the intermediary and/or the directors which could result in the imposition of administrative penalties.
What criminal penalties may apply?

Following the inspections carried out, in the event of breaches of the regulatory provisions, the regulators may impose criminal penalties such as fines and/or imprisonment.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

Registration taxes may apply on a lump-sum basis of €200 both on the grant of a loan and on the transfer of receivables for the purpose of financing. Additional stamp duties may apply both to the documentation of the loan and on the assignment.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Registration taxes are also applicable to the grant of security, depending upon the nature of such security. In principle (eg for a mortgage or pledge), registration taxes apply as follows:

- €200, if the security is securing the Italian company's own obligations; or
- 0.5% of the secured amount, if the security is securing third party obligations; and
- nominal stamp duty (usually at the rate of €16 per page).

In the case of mortgages over real estate, mortgage tax is payable at 2% of the secured amount (0.5% of cancellation) unless the mortgage has been released to cover a receivable covered by the Substitutive Tax (in which case, it is exempt from any indirect tax, see below).

In the case of securities securing a loan (or a financing structure set up via the issuing of a bond, according to the law), provided that:

- the loan has an initial contractual duration of at least 18 months and one day;
- the loan is advanced by an EU-incorporated bank or an Italian branch of an EU incorporated bank; and
- the facility agreement is executed in Italy.

The payment of registration taxes, mortgages and cadastral taxes, stamp duties, governmental duties and all the other taxes and duties (other than income tax and withholding taxes) on related documents, including (and in particular) all documents relating to a security package, can be substituted (at the option of the bank) by an alternative tax (ie the imposta sostitutiva, or the Substitute Tax). The Substitute Tax is an umbrella tax applicable (currently) at a rate of 0.25% on the principal amount of the loan (the amount of the Substitute Tax is typically retained by the bank from the relevant drawn amount).

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

The assignment of a debt would be subject to the following registration taxes:

- €200, if the assignment is securing the Italian company's own obligations; or
- 0.5% of the secured amount, if the assignment is securing third party obligations; and
• nominal stamp duty (usually at the rate of €16 per page).

As said, please lease note that the Substitute Tax may also apply to guarantees related to the issuing of bonds.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g., secured bond holders)?

Yes, the Italian state usually has a special privilege on any debt associated with indirect tax.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Interest paid by an Italian resident borrower to an Italian resident lender (including an Italian permanent establishment of a non-resident entity) is not subject to withholding tax. In the case of lenders not resident in Italy, interest payments are subject to a final withholding tax.

If so:

What is the rate of withholding?

Domestic withholding tax on interest payments is applicable at 26%.

What are the key exemptions?

Exemptions from withholding tax apply in the case of medium- and long-term loans when the interest is paid to:

• a bank or a financial institution authorized or licensed to carry out banking activities within the territory of Italy, and resident in Italy for tax purposes (and not acting through a permanent establishment located outside of Italy);

• a credit institution which is resident or established in an EU member state, and not acting through a permanent establishment located outside of the EU;

• an insurance company incorporated in and authorized under the laws of an EU member state; and

• an institutional investor not resident in Italy, but resident or established in a state or territory allowing for an adequate exchange of information, provided that it is subject to supervision in the respective jurisdiction of establishment.

An exemption from withholding tax may be applicable under the EU Interest and Royalties Directive as implemented in Italy.

An exemption may also be applicable under the double tax treaties entered into by Italy. However, double tax treaties signed between Italy and other EU countries usually only reduce the amount of withholding tax applicable to a 10% rate.

Some exemptions may also apply to interest on loans granted or guaranteed by public entities.

Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower?
(other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

In general terms interest on bonds paid to foreign qualified investors is exempt from withholding tax and the securities to the bond may benefit, upon specific option, to the Substitutive Tax regime.

Key contacts

Agostino Papa
Partner
DLA Piper Studio Legale Tributario
Associato
agostino.papa@dlapiper.com
T: +39 06 68 8801
Ivory Coast

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities both under OHADA Law and the Regulations of the CREPMF.

Under the General Regulation of the CREPMF, offering and selling debt securities is subject to prior authorization of the CREPMF and the stamp of approval of the information notes.

Any proposed public offer for listed securities must be approved in advance by the Regional Council (Article 123).

An information note is to be established and must contain information according to the types of public offer in question and is subject to prior distribution.

When issuing public debt securities by a State or a group of States, their governments draw up an information note which is transmitted to the Regional Council before the date of issue of the securities.

That note is exempt from the prior visa before its distribution to the public.

The note for the issuance of public debt securities by local public authorities or guaranteed by a State or a group of States is subject to the prior visa of the Regional Council (Article 2 of Decision No. CM 05/09/2005 modifying article 136 of the General Regulations relating to the organization, operation and Control of the WAMU Financial Market).

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What are common issuing methods and types of debt securities?

The most common types of debts securities issued in the WAEMU are bills and bonds.

Other different types and forms include:

- asset-backed securities
- debt securities
- derivative securities
- hybrid securities such as convertible bonds
- equity-linked securities such as convertible bonds
- exchangeable bonds
Issuance of treasury bills and bonds:

The issuance of Treasury bills and bonds (issued by the State, under the responsibility of the Minister of Finance) is subject to a tender or a syndication procedure, organized with the assistance of the WAMU Securities Agency (Agence UMOA-Titres).

Open tenders: Primary subscription of treasury bills and bonds are reserved to credit institutions, brokerage firms and regional financial investors holding settlement accounts with the Central Bank. Other investors, whether they are private individuals or corporations, may also subscribe through credit institutions or brokerage firms established on the territory of the Union.

Targeted tender: States may decide to hold part of their issuance through targeted auctions restricted only to their Primary Dealers.

Any investor wishing to acquire the security put out to tender can subscribe through them.

Issuance of Treasury Bonds by Way of Syndication is carried out in accordance with the applicable regulatory provisions as set out by the CREPMF.

What are the differences between offering debt securities to institutional/professional or other investors?

The main difference between offering debt securities to institutional/professional or other investors lies in the fact that institutional and professional investors are more experienced and sophisticated and able to understand the information provided on the listing documents and make sound investment decisions.

Other investors, including retail investors, need more detailed information and advice to be able to understand the investment documents and make sound financial decisions. They also need more protection.

There is, generally, no essential distinction between professional and other investors. However, one distinction is the channel through which financial securities are issued; for instance, bonds issued through public offerings and bonds issued on the market through auction.

When financial instruments are issued through public offerings, an investment syndicate made up of brokerage firms handles the sale to investors and the general public. After they are issued, they are listed on the BRVM.

As for financial securities to be issued through auction, primary subscription of treasury bills and bonds is restricted to credit institutions, brokerage firms and regional financial investors with settlement accounts with the Central Bank. Other investors, whether they are private individuals or corporations, may also subscribe to bills and bonds on the primary market through credit institutions or brokerage firms established on the territory of the Union.

Securities issued through auction are not listed on the regional stock exchange (BRVM).

When is it necessary to prepare a prospectus?

It is necessary to prepare an information note (concept used in the WAMU instead of prospectus) for any proposed public offer for listed securities, which must be approved, in advance, by the Regional Council. It must contain specific information according to the types of public offer concerned. (Article 123 of the General Regulations of the CREPMF).

When a State or a group of States intend to issue public debt securities, their governments draw up an information note which is transmitted to the Regional Council before the date of issue of the securities.

Any solicitation transaction must be accompanied by the sending or handing over to the solicited person of the information note or any other explanatory document, endorsed where appropriate, with the approval of the Regional Council before any initial issuance (Article 157).
What are the main exchanges available?

The Regional Stock Exchange (BRVM) is the main stock exchange available and it is shared by the eight member states of the WAEMU. The stock market is divided into two markets which correspond to two levels: the primary market and the secondary market.

The primary market

The role of the primary market is to bring together companies looking for financings and capital holders.

The BRVM is regulated and issuers are to comply with different rules and regulations.

On the primary market, securities are issued by companies (issuers).

New issuance of securities is and may be done through the primary market during an IPO or a capital increase.

Securities issuance of a company that goes public can be done on the primary market and those securities may be purchased by investors. The latter will then put those securities back up for sale on the secondary market.

The secondary market

This market is far from being active. On the secondary market, stakeholders and investors exchange issued (on the primary market) securities to be offered to savers. Investors will be able to trade these securities among themselves on the secondary market.

Transactions on this market are conducted through certified intermediaries such as banks, non-bank financial institutions, regional financial institutions, asset managers and brokerage firms.

Is there a private placement market?

Yes, there is a private placement market in Ivory Coast and with the multiplication of private financial institutions in the WAEMU zone, more financing investments are thus being provided for companies and individuals.

That multiplication, combined with technological changes and developments, make access to offers and opportunities easier and more and more investments are being made through the private market in several sectors such as real estate, insurance and the like.

There is no dominant standardization of private placement documentation, the ones from the Loan Market Association (LMA) are sometimes used.

Are there any other notable risks or issues around issuing or investing in debt securities?

Risks are of different types:

Foreign exchange risk: the rate of a currency may increase and cause the value of assets denominated in a different currency to decrease.

Interest rate risk: interest rate variations may lead to more cost or loss of income for an investor.

Liquidity risk is the risk of the impossibility to sell a financial instrument at a certain price.

Inflation risk may occur when repayment is made in a depreciated currency or when an investor ends up with a rate of return below the rate of inflation.

Regulatory risk: changes in Laws or Regulations may have an impact on investments in debt securities.

Solvency risk: borrowers may be unable to meet their commitments and creditors may lose their claims.
Political risk: this type of risk is associated with a political situation where authorities change their tax systems, the ability to repatriate capital and the like.

Risks or issues around issuing debt securities mainly lie on issuers being required to assume responsibility for information relating to debt securities. Any applicable offer document must have the stamp of approval of the CREPMF, failure of which may result in the nullity of the proposed financial transaction and result in criminal and civil penalties.

**Establishing and investing in debt / hedge funds**

*Are there any restrictions on establishing a fund?*

**Generally**

Establishing and operating a fund, offering fund securities are regulated activities under the General Regulations of the CREPMF and therefore subject to regulation by that organization and other organizations.

**Collective Investment Schemes**

Collective investment schemes include the following arrangements:

Undertakings for Collective Investment in Transferable Securities (UCITS) are financial institutions that collect savings from economic actors and issue stocks or shares. The savings collected are used to set up securities portfolios and to provide financing for businesses.

The activities of UCITS are classified collective asset management which has two subcategories:

- Management for proper account: funds collected from third parties by the fund are invested in all types of securities and other financial products such as bonds, equities, negotiable debt securities and the like.
- Discretionary management: the fund is managed privately as the collective investment funds belong to third parties.

**What are common fund structures?**

Two types of UCITS have been authorized on the Regional Financial Market.

Common forms of funds include:

- open-ended, Investment Companies with Variable Capital, ICVCs (SICAV in French);
- mutual investment funds (*Fond Commun de Placement, FCP*);
- qualified investor structures that invest in products such as corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

**What are the differences between offering fund securities to professional / institutional or other investors?**

**Retail funds**

Considered as laypersons, retail investors need more detailed information and advice to be able to understand the investment documents and make sound financial decisions. They also need more protection.
Based on those considerations, UCITS for instance, being one type of entity through which retail investments are made, are to be authorized by the CREPMF and are subject to considerable regulation.

**Institutional/Professional funds**

They are usually subject to less protective regulations.

Institutional and professional funds are considered more experienced and sophisticated and able to understand and make sound financial and investment decisions.

However, there is a legal and regulatory framework in place to secure subscribers based on the control mechanisms set up by the Central Depository/ Settlement Bank (DCBR) and the CREPMF.

**Are there any other notable risks or issues around establishing and investing in funds?**

Investment management is a regulated activity and entities wishing to conduct such an activity are to be authorized by the CREPMF.

Risks and issues are of different types:

Currency or Foreign exchange risk: investments in securities may be made in different currencies. The rates of currencies may change and the value of a fund's investment be affected. Investments in a foreign market may entail exchange of currencies where an investor may have to exchange a domestic currency into a foreign currency, at an actual exchange rate, and convert it back into his domestic currency. Such conversion transactions may constitute risks that need to be mitigated.

Liquidity risk is the risk of the impossibility to sell a financial instrument at a certain point of time.

Diversification risk: investors may be exposed to risks when they invest in only one asset class or in a very limited number of assets. Such restrictive investments do not help in mitigating the risks inherent to the lack of diversification on such investments.

Solvency risk: borrowers may be unable to meet their commitments and creditors may lose their claims.

Political risk: this type of risk is associated with a political situation where authorities change their tax systems, the ability to repatriate capital and the like.

Risks and issues are to be nuanced as there are substantial protections such as the one provided for by the CREPMF acting as a regulatory agency entrusted with the protection of household savings invested in securities or any other type of investment through public offerings within the WAMU.

Further protection is provided, for instance, under Article 15.3 (Instruction N. 45 / 2011 of the CREPMF) and requires that UCITS' assets be kept by a single depository, distinct from the UCITS management company.

National and Sub-Regional Legislations recognize the segregation of the assets of the Depositary's UCITS Clients from the sub-custodian's own assets.

Those assets are, in some way, protected through entities like the deposit guarantee fund (Fonds de Garantie des Dépôts, the FGD-UMOA) in the WAMU.

The FGD-UMOA's mission is to provide deposit guarantees for customers of credit institutions and decentralized financial systems (DFS), approved in the WAMU.

As such, it is responsible for the compensation of depositors in the event of unavailability of their assets, within a limit defined by the Council of Ministers of the WAMU.
Are there any restrictions on marketing a fund?

Marketing is a proposition for the acquisition of investment products. It is, mostly, dealt with under the concept of solicitation.

Individuals intending to conduct public solicitation activities (business providers, direct sellers) are required to obtain a professional card issued by the Regional Council (General Regulation of the CREPMF, Article 108: The solicitation of the public).

Financial institutions, such as banks, wealth management companies, management and intermediation companies (SGI), business providers, individual or legal persons authorized for that purpose, are allowed, as of right, to have recourse to solicitation after reporting to the Regional Council (Article 155).

Solicitation of the WAMU’s public by a non-resident entity, or on behalf of it, to propose the acquisition of investment products is subject to prior authorization of the Regional Council and the assent of BCEAO (General Regulation, Article 176).

Reverse solicitation: is not specifically provided for under the applicable rules and regulations.

Prospective investors do, sometimes, make the first move, take the initiative to contact investors for potential acquisition of financial products. The financial entity needs to have evidence that the potential investor solicited them.

Are there any restrictions on managing a fund?

Fund management in the WAMU is regulated under the General Regulations of the CREPMF and various implementing instruments.

The CREPMF regulate and authorize public offerings by delivering its approval. It monitors all private organizations on the market. For this purpose, it certifies all commercial stakeholders: brokerage firms, fund managers, and individual entities (intermediaries and soliciting dealers).

The collective management of transferable securities is carried through UCITS, divided into open-ended investment company (SICAV), in Mutual Funds (FCP) or any other form of Undertaking for Collective Investment in transferable securities (UCITS) approved by the Regional Council.

Undertakings for Collective Investment in Transferable Securities.

UCITS’ management is governed by the regulations in accordance with the General Regulations of the CREPMF and Instructions 44, 45, and 46.

Mutual funds that hold more than 5 billion FCFA assets are required to set up a system of controls and monitoring specified under article 7 of Instruction N° 46/2011 (Revised) Relating to the Classification and Allocation Rules Assets of Collective Investment Organizations on the Regional Financial Market of the WAMU such as a supervisory committee, an Internal Control reporting system, and a reporting system for the FCP Custodian. The maximum assets that a Mutual Fund can hold is set at twenty-five (25) billion FCFA.

Any FCP which comes to hold assets in excess of 25 billion FCFA must declare it without delay to the Regional Council.

No FCP can hold, during six consecutive months, an asset greater than 25 billion FCFA, in which case the FCP must, within a six (6) month period, be transformed into a SICAV or be subject to a demerger.

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

There is no specific legislation on derivatives. Provisions on derivatives can be found in different legal texts.

Certain restrictions do apply.

Businesses and entities proposing derivative contracts and products are to receive prior authorizations (from CREPMF and BCEAO).
The 2014 Uniform Act on commercial companies and Regulation 09/2010 contain some provisions on derivatives. As per article 744 of that Uniform Act, public limited companies issue transferable securities whose form, class and characteristics shall be defined by the competent body of each state party.

Residents are authorized to conduct transactions on foreign exchange derivative markets through licensed intermediaries or foreign banks (article 12 of Regulation 09/2010).

Authorized transactions must be backed by trade or financial transactions, subject to compliance with all other regulatory provisions applying to the aforementioned transactions.

A limited number of commercial or financial transactions on derivatives can be conducted by residents. They are authorized to carry out commodity derivative transactions on commodity futures markets (Article 13: Commodity derivatives).

They may use foreign exchange derivatives to hedge foreign-exchange risks, for the following commercial or financial transactions:

- imports and exports of goods and services by residents;
- foreign loan transactions by residents (draw-downs and payments); and
- direct foreign investments in a resident enterprise under negotiation.

Residents may use derivatives to hedge price risks. Those derivatives must be backed by commodity imports or exports carried out by the residents. They are not authorized to purchase commodities on foreign markets for delivery in commodity derivative transactions (Article 18).

What are common types of derivatives?

The main types of derivatives are:

- futures;
- forwards;
- options; and
- swaps.

The value of the derivatives is derived from the value of an underlying asset or group of assets, the main classes of which are:

- Assets: commodities, shares or bonds;
- Interest rates, exchange rates, or indices;
- Foreign currencies.

Are there any other notable risks or issues around entering into derivatives contracts?

- Market risk
- Liquidity risk
- Counterparty risk
- Commodity price risk
- Exchange rate risk
- Interest rate risk
Risks are not that notable as the majority of the activities are conducted between sophisticated persons and are to a certain extent reserved for banks, and national and regional financial institutions which have a depository account with the Central Bank.

Residents are authorized to conduct transactions on foreign exchange derivative markets through licensed intermediaries or foreign banks (Article 12 of Regulation 09/2010).

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, a lender will need to be authorized by the BCEAO to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements.

There are, however, some restrictions on lending.

WAEMU residents who intend to borrow and invest abroad are required to get prior authorization from the Minister of Finance.

They must be at least 75% financed through foreign loans.

Foreign entities that intend to lend to WAEMU residents who want to invest abroad are required to finance those latter at a minimum percentage of 75% (Article 10: Investment transactions).

There are particular restrictions for regulated mortgage contracts including on how the loans must be advertised. It is forbidden to advertise repayments or to refer to social security benefits that are not insured for the duration of the contract.

Lenders administer the loans on an ongoing basis; and borrowers who fall behind with their payments are dealt with.

Regulated credit agreements, on the other hand, have specific requirements around how the agreement is drafted and formatted and what information must be included.

Borrowing

Yes, there are some restrictions on borrowing.

Regulation 09/2010 does, for example, provide one restriction pursuant to Article 10: Investment transactions, under which foreign investments made abroad by WAEMU residents are subject to prior authorization from the Minister of Finance.

Moreover, they must be at least 75% financed through foreign loans.

Another restriction is provided for under article 11 where loans contracted by residents from non-residents must, except by special decision of the Minister of Finance, be carried out through licensed intermediaries in all cases where the monies borrowed are made available to the borrower in the country. The licensed intermediaries thus called upon to intervene will ensure that the transactions comply with the applicable laws and regulations.

All foreign loans are subject to mandatory declaration to the External Finance Directorate and the BCEAO, for statistical purposes.

In Ivory Coast, consumer credit is regulated through Consumer Law, Law n° 2016412 of June 15, 2016. It is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned under that Law.
What are common lending structures?

Lending structures in Ivory Coast depend on the parties’ projects and needs.

They can have recourse to individual lending where one lender provides for the loan or to syndicated loans where two or more lenders provide loans to one or more borrowers.

Syndicated loans involve large loans where the different participating banks share the risks as their liability is limited to the amount of their contribution.

Those syndicated loans are very complex transactions requiring the appointment of facility agents. Security agents are also appointed as provided for under Article 5 of the Uniform Act on Securities adopted on December 15, 2010.

Loans structuration depend on different parties’ objectives, they can be commercial loans, concessional loans, non-concessional loans, equity loans, long term loans, short term loans, or alternative forms of financing.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for a set period of time that usually lasts between one and ten years but can last a bit longer up to thirty years;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be withdrawn, repaid and redrawn if repaid; it provides for more flexibility and it can be reused as it is repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a bridge loan gives access to short term loans that allow to meet short-term liquidity gaps or needs.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, refer to, among other texts, the Uniform Act on Securities.

Loan commitment

A loan can also be:

- committed, whereby it provides for terms and conditions imposed on the borrower and the lender is obliged to provide the loan if those terms and conditions are fulfilled; or
- uncommitted, meaning that the lender is not committed to provide the loan.

Loan repayment

The funds can be repaid on demand, in instalments, or scheduled to be repayable in full at maturity.

What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective as they are considered as more experienced and knowledgeable that other categories of borrowers.

By contrast, lending in the context of mortgages and to consumers is a more regulated activity and as such requires more protection and BCEAO authorizations. For more information, see Consumer Law, Law n ° 2016412 of June 15, 2016.
**Do the laws recognize the principles of agency and trusts?**

Ivorian laws do, specifically, recognize the principle of agency but not the principle of trust.

However, the Uniform Act on Securities recognizes the concept of Security Agent which may be considered as a corresponding concept to the Security trustee.

The security agent is provided for under Article 5 of the Uniform Act on Securities which provides that "Any security or other guarantee to secure the discharge of an obligation may be made, registered, managed and executed by a financial institution or a national or foreign credit company acting in its own name and as surety agent appointed for that purpose by the creditor of the secured debt."

*Last modified 3 Aug 2020*

**Are there any other notable risks or issues around lending?**

Yes, there are some risks and issues around lending.

Generally, contractual principles apply to loan agreements and other finance documents.

Those risks may be credit risks, default risks, interest rate risks which may be capped to a certain rate, percentage, exchange rate risks for cross-border transactions, security risk value.

**Specific types of lending**

Banks also acting as lenders in the real estate sector have access to other sources for their lending activities through, among others, the creation, in 2010, of the WAEMU Regional Mortgage Refinancing Fund (Caisse Régionale de Refinancement Hypothécaire de l'UEMOA). That fund was created by the West African States Central Bank, the West African Development Bank (Banque Ouest Africaine de Développement (BOAD)) and the CREPMF.

Through that fund, they are able to access international capital markets and get resources for the funding of their mortgage activities.

One of its missions is to provide resources for the refinancing of mortgage loans to credit institutions in the WAEMU through the issuance of loans on the regional financial markets or through concessional financing from development partners.

Insurers in the WAEMU also invest in real estate, through pension funds, for long-term capital to the housing industry. Ivory coast has two main pension funds: the National Social Insurance Fund (CNPS) dedicated to the private sector and a shareholder of two banks, Société Générale and Attijariwafa Bank, and several investments funds (Amethis, Yelen and AfricInvest). The other fund is the General pension fund for civil servants (Caisse générale de retraite des agents de l'État).

**Standard form documentation**

Banks have their own standard form documentation that are used during bilateral finance transactions.

Cross-border financial transactions are sometimes based on the Loan Market Association standard documentation or on other standard forms.

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**Are there any other notable risks or issues around borrowing?**

Missed payments can lead to risk defaults and collections processes which can have an impact on one’s credit history or rating.

It can also lead to difficulties in accessing to credit in the future.

There is also a possibility of loss of property in case of default as collateral pledging can be very important on the borrower’s part.

*Last modified 3 Aug 2020*
Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

There are some restrictions on key areas affecting the giving of guarantees and security.

**Capacity**

Capacity or the power of a company in such an area is to be assessed on the basis of the constitutional documents of the company granting a guarantee or security. Such giving of guarantees and security have to be approved by a resolution of the board of Directors of the company.

**Insolvency**

Guarantees and securities may be declared void in situations provided for under the Uniform Acts.

Acts done by the debtor during the suspicion period from the date of suspension of payments to the date of the decision to open proceedings shall as of right be non-binding or may be declared non-binding on the body of creditors as defined under Article 72 of the Uniform Act on Collective Proceedings for Debt Clearance.

The following shall as of right be non-binding on the body of creditors if and when they are done during the suspicion period: any conventional mortgage or conventional pledge, any constitution of pledge, granted on the debtor’s property for debts previously contracted, any provisional registration of a conservatory judicial mortgage or a conservative judicial pledge.

**Financial assistance**

A company is prohibited from purchasing its own shares. Managers are prohibited from contracting, under any form whatsoever, loans from the company, obtaining an overdraft on a current account or otherwise from the company or making the company endorse or guarantee their commitments towards third parties.

This prohibition shall also apply to spouses, ascendants and descendants of the persons referred to above, including any intermediary through whom these persons act.

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What are common types of guarantees and security?

**Common forms of guarantees**

Under OHADA, personal securities are surety bond and autonomous guarantee and counter guarantee.

Surety bond: A surety-bond shall be a contract whereby the surety undertakes, and the creditor accepts, to discharge an existing or future debt contracted by the debtor in the event of the latter failing to do so.

Autonomous guarantee and counter guarantee:

An autonomous guarantee shall mean an agreement by which the guarantor undertakes, following an obligation signed by the principal and on its instructions, to pay a fixed sum of money to a beneficiary either at the earliest demand of the latter or as per the agreed terms. The autonomous counter guarantee shall mean the agreement by which the counter guarantor undertakes, following an obligation signed by the principal and on its instructions, to pay a fixed sum of money to a guarantor either at the earliest demand of the latter or as per the agreed terms.

Transferable securities consist of possessory lien, assets held or transferred as security, pledge of real property, pledge of intangible assets and privileges.

**Common forms of security**
Pledge

Liens

Mortgage

Different types of security are suitable for securing different types of assets.

Under Ivorian law it is possible to grant security over all of the assets of a company or on individual assets. Granting security over all of a company’s assets will tend to be achieved by way of a debenture which will include:

- a mortgage over real estate; and
- a pledge over movable goods.

Moreover, guarantees and security, to be enforceable as against third parties need to be perfected and registered.

Are there any other notable risks or issues around giving and taking guarantees and security?

To be valid, a guarantee needs to be in writing and contain some necessary elements:

General contractual principles apply to consideration for a guarantee.

The underlying obligations will usually be the consideration for the guarantee and the execution of the underlying obligations, and the guarantee should be concomitant to avoid a possible qualification of past consideration.

There should generally be no issue as in the majority of cases, the guarantee is provided for in an underlying document as in the case of a loan agreement.

A guarantee may be set aside for different reasons and a beneficiary of a guarantee should take those into account and avoid them.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Investment activities/services:

In Ivory Coast, investment activities/services are mainly regulated by the following Laws and Regulations:

Investment Code of Ivory Coast adopted on August 1, 2018, through Ordinance No. 2018-646 of August 1, 2018, and Decree 2018-64

The General Regulations of the Regional Council for Public Savings and Financial Markets (Règlement Général du Conseil régional de l'épargne publique et des marchés financiers, CREPMF) (General rules of the CREPMF);

General rules of the Regional Stock Exchange (Bourse Régionale Des Valeurs Mobilières, BRVM);

Framework Law on Banking Regulations of the WAMU, December 3, 2010

Regulation No. 09/2010/CM/UEMOA/ on External Financial Relations of the Member States of the West African Economic and Monetary
Union (WAEMU)

Ordinance no. 2009-385 of December 1, 2009 (Banking Law)

**Consumer credit, Corporations, Mortgages, Funds and platforms**


**Corporations**

Revised Uniform Act on commercial companies and economic interest groups (the Revised Uniform Act), adopted on January 30, 2014

**Mortgages**

Uniform Act Organizing Securities of December 15, 2010

**Funds and platforms**

Regulation No. 02/2010 / CM / UEMOA relating to securitization mutual funds and securitization transactions in the WAEMU (Règlement n° 02/2010/CM/UEMOA relatif aux Fonds communs de titrisation de créance et aux opérations de titrisation dans l'UEMOA)

Instructions 44, 45, and 46 of CREPMF and regulation on the organization and functioning of the financial market of the WAEMU.


Regulation No. 03/2010 / CM / UEMOA relating to covered bonds in the WAEMU

**Other key market legislation credit**

Regulation n ° 06/2013 / CM / UEMOA of June 28, 2013, on Treasury bills and bonds issued by auction or syndication with the assistance of the WAMU Securities Agency (Agence UMOA-Titres)

Decision No CM / SJ / 001 / 03/2016 Relating to the Implementation of the Monetary Penalties Mechanisms Applicable on the Regional Financial Market of the WAMU

Ivoirian Financial Markets Act 1974

Regional financial markets Instruction 2011

Uniform Act on simplified recovery procedures and measures of execution

WAEMU Instruction governing activities of electronic money issuers 2015

Ivory Coast Electronic Transactions Act 2013

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**Regulatory authorization**

**Who are the regulators?**

The Financial Market Authority is the Regional Council for Public Savings and Financial Markets (CREPMF). It regulates the functioning of the market and authorizes public offering procedures by granting visas.

It enacts rules and regulations concerning the regional stock market, market access conditions, publicity rules and information of the public.

It has the power to control the different stakeholders operating in the regional market.
The Regional Stock Exchange (BRVM) is responsible for organizing the stock market; ensuring the listing and trading of securities; ensuring the dissemination of stock market prices and information; promoting and developing the market.

The Central Bank of the West African States (BCEAO) issues currency, manages monetary policies, and organizes and monitors banking activities in general.

The WAMU Securities Agency (Agence UMOA Titres) assists states using the regional and international capital markets to raise their needed resources to finance and fund their economic development through the identification of the most suitable means.

What are the authorization requirements and process?

The main authorization requirements are the granting of an approval and/or a visa depending on the type of entity or individual. Under the General rules of the CREPMF, some investment activities require an approval (agrément) from the CREPMF and others require authorization(s) from both the CREPMF and BCEAO (Regulation 09/2010).

In accordance with the applicable, the conduct of the following activities on the regional financial market, without this list being exhaustive, is subject to the approval or authorization of the Regional Council: securities trading, maintaining securities accounts, reception and transmission of orders, presentation of daily buy and sell offers, asset management mandates, financial marketing or solicitation, collective asset management, debt securitization (titrisation des créances), financial rating, financial transaction guarantee (garantie des opérations financières),

Once applications are received, they are assessed within a one- to three-month period from the date of filing of the application.

The application fee depends on the type of entity and the nature of the activity ranging from XOF500,000 to XO50 million.

The application process will end up with an individual decision by the Regional Council (CREPMF).

A list of authorized entities and individuals can be found with the CREPMF and the Regional Stock Exchange (BRVM).

What are the main ongoing compliance requirements?

Approved or authorized entities have continuous obligations such as sufficient guarantees, in particular with regard to the composition and amount of their capital, their organization, their human, technical and financial resources, the integrity and experience of their managers, as well as their own measures to ensure the security of clients' transactions.

They must undertake, in writing, that any modifications made to their statutes during the course of their existence are subject to the prior authorization of the Regional Council when they relate to a distribution of capital between shareholders, a change in the scope or nature of the guarantees presented, a change in the accounting methods and information used, any other modification of the statutes is the subject of information to the Regional Council.

In case of failure of those entities to comply with key requirements, the Regional Council can take steps to restore compliance with the rule. If violations continue, it can decide on the sanctions to be taken, in accordance with the provisions of the General Regulations, in particular the suspension of all or part of their activities.

What are the penalties for failure to be authorized?

A person, be it a natural or legal person, undertaking a regulated activity without being approved, authorized or exempted is liable to a certain number of sanctions.

Failures are classified into four categories and subject to a quantum of financial penalties.

The quanta apply to any stakeholder in the regional financial market as well as to any natural or legal person responsible for non-compliance.
Failure, for instance, to obtain a visa by the Regional Council results in the nullity of transactions, both with regard to the applicant and the solicited public. In addition, issuers are liable to sanctions from the Regional Council, without prejudice to legal proceedings (Article 115 of the General Regulation of the CREPMF).

Regulated activities

What finance and investment activities require authorization?

Generally

Combined provisions of the General Rules of the CREPMF and the Regulation 09/2010 provide for the financial and investment activities that require authorization.

Under the General rules of the CREPMF, the following activities qualify as investment activities that require an approval (agrément): issuing and distributing securities; trading and intermediation on the securities market; trading and intermediation on the derivatives market; organization and operation of stock exchanges; organization and operation of commodities and futures exchanges; management of securities portfolios and custody of securities; and provision of investment advice.

Persuant to article 8 of Regulation 09/2010, the following activities require an authorization from CREPMF and BCEAO: the issue, the exposure, the sale of securities of foreign states, public authorities or foreign companies and international institutions; the solicitation of residents with the aim of constituting deposit funds with foreign private individuals and offshore establishments; any publicity or marketing... edited on the territory of a WAEMU's Member State with the aim of investing offshore funds or subscribing to operations related to offshore real estate constructions.

Consumer credit

Consumer credit activities, including hire-purchase and rental with option purchase, discount, reverse repurchase, acquisition of receivables, guarantees, purchase financing, leasing and service delivery are regulated activities.

Furthermore, these activities can only be offered by firms who are authorized and listed on the financial services register.

Are there any possible exemptions?

All transfers of securities listed on the Regional Stock Exchange are made through an SGI, except in the case of an exemption granted by the Regional Stock Exchange (Article 37 of the General Regulation of the CREPMF).

Moreover, pursuant to article 95, no one may, as a usual profession, without the prior authorization from the Regional Council, provide investment advice, in particular of a stock market nature, to third parties.

However, SGIs and banking institutions are authorized to exercise the activity of stock market investment advice by way of derogation from the preceding article (Article 96).

Do any exchange controls or other restrictions on payments apply?

Transfers are, in principle, free.

However, some exchange controls and other restrictions on payments apply.

Under article 2 of Regulation n°09/2010/CM/UEMOA, foreign exchange transactions, capital movements (issuance of transfers and/or
receipt of funds) and settlements of all kinds from a WAMU Member State to a foreign country or in the WAMU space between residents and non-residents can only be made through the BCEAO, the Administration or the Post Office, a licensed intermediary or a licensed manual exchange agent.

Licensed intermediaries are allowed to perform the following activities to a destination abroad, under their responsibility and on the basis of supporting documents (art. 7 of the Regulation n°09/2010/CM/UEMOA):

- the transfer of money required for contractual debts amortization as well as short-term repayment of loans granted for the financing of commercial and industrial operations;
- the transfer of the liquidation proceeds of investments or the sale of foreign securities by non-residents;
- the required settlements, either for transactions on derivative instruments or for transactions on commodity derivatives and basic products.

Payments to foreign destinations in respect of capital transactions, other than those provided above, must be done based on an application for foreign exchange authorization submitted to the Minister of Finance.

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**What are the rules around financial promotions?**

A financial promotion is a proposition for the acquisition of investment products. It is, mostly, dealt with under the concept of solicitation.

Individuals intending to conduct public solicitation activities (business providers, direct sellers) are required to obtain a professional card issued by the Regional Council (General Regulation of the CREPMF, Article 108: The solicitation of the public).

Financial institutions, such as banks, wealth management companies, management and intermediation companies (SGI), business providers, individual or legal persons authorized for that purpose, are allowed, as of right, to have recourse to solicitation after reporting to the Regional Council (Article 155).

Solicitation of the WAMU's public by a non-resident entity, or on behalf of it, to propose the acquisition of investment products is subject to prior authorization of the Regional Council and the assent of BCEAO (General Regulation, Article 176).

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**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

The types of legal entity that are generally used to undertake financial or investment activity are limited companies, they can be private law companies incorporated as a public limited company.

That type of entity is used for the Regional stock exchange (BRVM) and the Central Depository/Settlement Bank under Article 12 of the General Regulation, where they are specifically characterized as “private law companies incorporated as a public limited company.”

Management and intermediation companies are to be established as Public Limited Companies (Société Anonym, Article 30).

**Funds**

Open-ended investment companies (SICAV) are also to be established as Public Limited Companies (Instruction N ° 21/99 Relating to the Classification of UCITS, Article 2).

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**Is it possible to conduct lending or investment business through a branch or establishment?**
Yes, it is possible to conduct lending or investment business through a branch or establishment in Ivory Coast.

A company can conduct lending or investment business in Ivory Coast through an establishment (also known as a branch), but the entity must be incorporated as a public limited company during the registration process with the trade register.

Furthermore, overseas companies carrying on a trade in Ivory Coast through a permanent establishment will be subject to Ivory Coast corporation tax.

**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

The most common technology products and fintech applications used or being developed in the finance and investment marketplace are:

**PEER-TO-PEER FUNDING PLATFORMS AND MARKETPLACE LENDING**

Marketplace lending is characterized by wide variety of market participants and financing mechanisms. Among the principal characteristics of new marketplace lenders, one can name:

- the use of non-bank lending platforms established as a specialist corporate or special purpose vehicle (SPV) based structure;
- recourse to technology to leverage and optimize the lending platforms;
- bringing together borrowers and lenders, through platforms rather than using the traditional financing mechanisms.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- prepaid cards;
- consumer loans;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property lending.

**HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?**

Money raising is organized from a large number of people who contribute small amounts in order to fund projects, usually via internet. Recourse to those platforms has been increasing.

**BLOCKCHAIN, SMART CONTRACTS AND CRYPTOCURRENCIES**

Blockchain, smart contracts and cryptocurrencies are not regulated neither under WAEMU nor in Ivory Coast.

The Central bank (BCEAO) did not hide their negative position as far as cryptocurrencies are concerned. Such a position stems from a series of concerns especially in terms of protection of personal data, compliance with competition rules, national security and monetary policy. They have reiterated their concerns over Facebook's project to create a cryptocurrency called Libra under the following terms: "This cryptocurrency project is the source of many concerns among regulators, particularly in terms of protection of personal data, compliance with competition rules, national security and monetary policy," said the Central Bank's representatives in their monitoring report for financial services backed by electronic payment.

Money creation is strictly controlled by a central authority, which issues and destroys it.
It is in the same line of thought that the CREPMF have, many times, recalled the regulations. On the money market, only a bank can hold an authorization and provide a financial guarantee from the BCEAO to be able to collect money from the public against the payment of interest.

The situation is not different in the financial market, where only an SGI has the same authorization from CREPMF.

**INITIAL COIN OFFERINGS AND TOKEN-BASED PRODUCTS**

Initial coin offerings and token-based products have not been subject to rules and regulations within the WAEMU. Their use is not tolerated in the WAEMU zone. Ivory Coast, being part of the eight WAMU member countries, has not allowed the creation or use of digital currency.

Money creation is strictly under the power and control of a central authority, BCEAO.

Please refer to response above it (Topic 13).

**ARTIFICIAL INTELLIGENCE AND ROBOT ADVISORY SYSTEMS**

Artificial intelligence and robot advisory systems are not specifically regulated in the WAEMU or in Ivory Coast.

However, as a tool using telecommunications, it is subject to the provisions contained in the telecommunication code.

In Ivory Coast, telecommunication activities are controlled by the regulatory authority, which is ARTCI (Ivory Coast Telecommunications Regulatory Authority).

Such an activity is not regulated; however, its use is being promoted withing the WAEMU zone, including among youngsters as was the case of a competition organized under the auspices of the of the regional stock exchange, the "BRVM Fintech Innovation challenge" launched by the Regional Stock Exchange (BRVM). The Ivorian recipient, Mr. Cédric Arthur Yao, presented "the Fetish project," an application dedicated to technical analysis on the stock market. The aim of the proposed analysis model was to allow a short, medium and long-term investment orientation for securities and to anticipate possible price rises and falls. The intention of the Fetish application was to integrate this technical analysis model into a digital application.

**DATA ANALYSIS AND CLOUD COMPUTING**

Cloud services are at their early stage in Ivory Coast.

They are used by banks for investments to improve customer experience and credit risks. Governments are also using them to provide certain public services.

_Last modified 3 Aug 2020_

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

The Regional council for public savings and financial market (CREPMF) is the regulator for the provision of financial products and services.

**General**

The conduct of regulated financial activities requires prior authorizations, approvals, generally, from the CREPMF and the BCEAO.

Some restrictions, specific laws, regulations and procedures may apply to fintech products.

Entities providing fintech products and services with regulated financial activity components are required to be authorized and comply with different laws, rules and regulations such as data protection and the like.

**Electronic payments platforms and regulation of peer-to-peer lenders**
Electronic payments platforms are governed through BCEAO Instructions, mainly Instruction N° 008-05-2015 governing the terms and conditions for the exercise of the activities of issuers of electronic money in the Member States of the West African Monetary Union (WAMU).

E-money transactions done through cards, internet and telephone are regulated under said instruction.

The definition of e-money has been made, taking into account “good international practice” and is characterized by a monetary value electronically stored, issued against funds provided in at least an equal amount and that has been accepted as a means of payment by both individual and corporate third parties.

Banks, payment services companies and microfinance institutions (MFIs) are allowed to issue e-money and can conduct e-money transactions.

Banks and payment services companies holding existing BCEAO licenses along with e-money authorizations, as FI issuers, must notify BCEAO (two months) in advance of any deployment, while microfinance institutions (MFIs) must get prior authorization from the Minister of Finances after BCEAO consent.

Nonfinancial companies may also issue e-money after obtaining a license. These issuers are called Etablissements de Monnaie Electronique (EMEs or non-FI issuers). They must meet separate standards on corporate governance and related matters to obtain a license. These EME companies must be solely dedicated to e-money issuance, (i.e. providing payment, transfer, and cash-in/out services. They cannot provide savings or credit services. EMEs can own shares only in other entities involved in e-money issuance.

**Peer-to-peer lenders**

It is important to mention that there is no specific regulation regarding this matter.

However, the need to regulate this type of product in order to protect consumers has been noted in some countries. The Regional Council and the BCEAO are conducting reflections in this direction, in order to propose protection mechanisms for consumers.

**Regulation of payment services**

Structures or establishments intending to exercise payment services are required to be duly approved or authorized, beforehand, by the Central bank. Banks and financial payment institutions authorized by laws regulating banking are allowed to conduct transactions related to payment services.

However, they are required to inform BCEAO, at least two months before the start of their electronic money issuance activities or the marketing to the general public, of any new money-related electronic service.

Electronic money institutions must be approved by the Central Bank before starting their electronic money issuing activities.

The exercise, by decentralized financial systems, of activities linked to electronic money, is subject to the prior authorization of the BCEAO. (Article 8 of the Instruction).

Electronic money institutions must have a specific legal form and corporate purpose. They must be constituted in the form of Joint Stock Companies or Companies with Limited Pluripersonal Liability, Mutuals, Cooperatives or Economic interest Groups.

With the exception of banks, financial payment institutions and decentralized financial systems, the issuance of electronic money can only be carried out by a legal person whose corporate object relates exclusively to this activity.

Diverse forms of electronic payment are available in Ivory Coast. These include the use of credit and debit cards, mobile phones, online payment services such as Paypal, Alipay or Apple using the iTunes card, bank transfers and payment upon delivery.

**Application of data protection and consumer laws**

Data Protection in Ivory Coast is regulated under Law No. 2013-45 of June 19, 2013 on the protection of personal data provides for the processing, transfer and other activities. The transfer of personal data to third countries is allowed subject to sufficient protection guarantees. The Ivorian's Data Protection Act 2012 (DPA) regulates the processing of personal data within the Ivory Coast. It implements the Supplementary Act on Personal Data Protection within ECOWAS.

Sensitive data collection, processing is subject to prior authorization from the Ivorian Telecommunications Regulatory Authority (Autorité
That Law regulates, among others, direct solicitation marketing by electronic means (Article 14).

The General Regulation of the CREPMF also regulates solicitation of the WAMU public (Article 176...).

Furthermore, there is a 2016 Ivorian consumer code that provides for consumer protection rules. It introduces competition rules and regulates consumer protection agencies in the marketplace.

**Money laundering regulations**

The applicable law is Law n° 2016-992 of November 14, 2016 relating to the fight against money laundering and the financing of terrorism (AML/CFT) and a decree gives competence to the Coordinating Committee to identify, assess, understand and mitigate the money laundering and terrorist financing risks to which the country is exposed. It is responsible for coordinating and conducting the work of the National Risk Assessment (ENR) and the elaboration of the National Strategy on AML/CFT.

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2015 give the National Financial Intelligence Processing Unit CENTIF responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment.

Generally, where a firm is authorized and supervised by the CENTIF, it will also be authorized and supervised by the CENTIF for complying with anti-money laundering requirements. Electronic currencies and other cryptocurrencies tend to represent a higher money-laundering risk.

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**Seed investment**

Foreign business angels, especially French ones, provided some fintech businesses with initial investments. For instance, Julaya, an Ivory Coast-based fintech startup raised USD550,000 to fund its activities in the country.

Startups may have support from individual or entities investors, experienced angels and partnerships with local and pan-African payment startups.

Such seed investment is often used to fund the establishment and early growth of the business before larger investment is sought and available.

**Crowdfunding**

The crowdfunding sector is at its early stage in Ivory Coast. Crowdfunding platforms have been launched bringing together individuals, entities and charities to finance personal and charitable projects.

“Orange collecte” has created a mobile crowdfunding platform and other telecom operators are expected to follow.

Crowdfunding has also been seen as a possible alternative through which foreign aid may be sent in order to resolve issues such as corruption. However, legal and regulatory obstacles have slowed that initiative that has been considered by foreign countries such as the UK.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage fintech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund, examples of which
include Santander InnoVentures and Citigroup's Citi Ventures. The benefit of having a CVC as an investor for a fintech startup is that the fund is able to share its knowledge and expertise of the fintech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

**Senior bank debt and capital markets funding**

Once a fintech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding, which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**Incentives and reliefs**

The investment code is intended to help investors with their potential projects in Ivory Coast. Indeed, international investors are urged to rely on local companies in the conduct of their operations in order to benefit from certain incentives offered by the new legal system.

The objective is, of course, to open up opportunities for SMEs and to give an inclusive character to Ivorian economic growth. Thus, large foreign companies eligible for the benefits of the new Code are entitled to tax credits provided that they apply a local content policy on job creation, opening of social capital to nationals and the outsourcing.

In concrete terms, an additional tax credit of 2% is granted to foreign investors whose number of executives and supervisory staff (management bodies such as directors, production manager, operational manager, sales manager, etc.) of Ivorian nationality represents 90% of the total workforce of these two categories of employees.

The same tax credit is granted to companies subcontracting to national companies the realization of goods intended to be incorporated into a final product in Ivory Coast or abroad. It also applies to companies that open their capital to nationals.

*Last modified 3 Aug 2020*

**Portfolio sales**

**Loan transfers and portfolio sales**

*What are common ways of buying and selling loans?*

Loans are commonly bought and sold.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio.

The most common ways of selling loans are:

Novation is a transfer of title of a party's rights and obligations. It's a tripartite arrangement between the existing parties and the transferee and results in a new contract between the continuing party and the transferee and the transferor being released from its obligations.

Assignment – a transfer of rights only and not of obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. An assignment can be effected as either an equitable assignment or a legal assignment.

The Loan Market Association documentation is sometimes used for loan transfers.

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*What are the main considerations when transferring a loan and related security?*
Loans contracted by residents from non-residents must, except by special decision of the Minister of Finance, be carried out through licensed intermediaries in all cases where the monies borrowed are made available to the borrower in the country. The licensed intermediaries thus called upon to intervene will ensure that the transactions comply with the applicable laws and regulations.

All foreign loans are subject to mandatory declaration to the External Finance Directorate and the BCEAO, for statistical purposes. The repayment of any foreign loan, either by purchase and transfer of foreign currencies or by crediting foreign accounts in XOF or in EUR, must be declared for statistical purposes to the External Finance Directorate and the BCEAO and said transactions must be carried out through a licensed intermediary.

Before transferring a loan, a number of issues, below, must be taken into account:

- Confidentiality: whether disclosure of information relating to the loan is allowed, to a potential transferee for instance.
- Data protection: whether there is any personal or restricted data or information in the loan that should not be disclosed.
- Lender eligibility: whether there are any restrictions on potential transferee entities.
- Undrawn commitment: whether the transferee will be subject to continuing obligations for further funding or reduction of claims.
- Transfer mechanics: whether there are any procedures to be followed for the transfer.
- Consent: whether the consent or notification of any other parties is required for the transfer.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Ownership of energy assets and infrastructure in Ivory Coast varies according to the asset class.

The key sectors are discussed below.

Energy

ELECTRICITY

Ivory Coast is expanding its production capacity following a higher demand for electricity not only at a national but also at a sub-regional level.

To have a more competitive sector and get the needed investments to respond to such a higher demand and proceed to the rehabilitation and expansion of distribution and transmission networks, new regulations have also been introduced in recent years. These take into account the attraction of the private investment and inclusion of the private energy companies which has led to a rise of the country's electricity capacity production.

The investments needed to upgrade the energy sector is expected to come from the private sector and in order to attract private investments from private companies, the government, through the Ministry of Petroleum, Energy and Renewable Energy Development (Ministère du Pétrole, de l’Energie et du Développement des Energies Renouvelables, MPEDER) offered incentives such as tax breaks. Though not negligible, more investment is needed, estimated at around EUR6 billion to develop and upgrade the sector for the 2021-2030 period.

In Ivory Coast, the energy sector is managed by and is under the control of the Energies de Côte d’Ivoire (CIENERGIE), a state company. It deals with the management of state-owned sector assets, ensures the financial equilibrium of the sector, manages the management of the purchasing functions, and movements of energy and the monitoring of the project management of works coming back to the state.

The regulator of the energy sector is the National Regulatory Authority of the Electricity Sector (ANARE). It monitors compliance with regulations, manages disputes between industry players, ensures the protection of consumers' interests and issues opinions on operating licenses and regulatory texts.
Gas

In Ivory Coast, gas industries are privatized. A number of private sector companies provide production, transportation and distribution services. Private sector companies involved own the generation, transmission and distribution assets are, in particular, FOXTROT, CNR, AFREN.

Biomass production has been introduced as a vital component of the country's renewable energy plans. The national grid is to be supplied by independent biomass energy producers. Feedstock coming from cocoa, palm oil, cotton, coffee and sugar plantations are used. A biomass power plant is currently under construction with a two-phase plan. The project, which costs XOF105 billion (EUR157.5 million), is a partnership between SIFCA, French electricity company EDF and French firm Bouygues, and it is set to become Africa's largest biomass power plant.

Tenders for two other biomass projects have been launched by the Ivorian authorities. The cost of the one to be built in the town of Boundiali is estimated at XOF29 billion (EUR43.5 million) and the other one to be built, a 20MW cocoa biomass plant is set to cost XOF21 billion (EUR31.5 million) and will be established in the city of Gagnoa.

Both will be established under build-own-operate (BOO) contracts.

Telecom Infrastructure

Telecommunication networks (fixed and mobile) is characterized by, composed of private ownership. Companies providing a number of services in the sector are Orange CI, MTN CI and MOOV CI.

The Ivorian Telecommunications Regulatory Authority (ARTCI) is the regulator of the telecommunications sector in Ivory Coast. It is also responsible for broadcast services and wireless communications services.

Aviation

Access to financing in the aviation sector is difficult to obtain and may be quite costly when available. Financing from commercial banks are hard to get including for aircraft acquisition.

Guarantees from the government were, at times, sought but reticence was encountered on the part of the government.

Aviation leasing is quasi inexistent on the continent and costly when in foreign markets.

However, financing through Export Credit Agencies (ECAs) have become a source of financing.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in the Ivory Coast over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (e.g. merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body (e.g. a government department, a local authority or a National Health Service Trust) is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval. Key sector-specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public-sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on Change of Control. This is less of a concern on private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.
Energy

ELECTRICITY

The electricity industry is managed by the Ivorian Electricity Company (CIE), which is by the state company. It is responsible for the distribution of electricity.

There are also independent power producers such as the Ivorian Electricity Production Company (CIPREL), AZITO Energy, AGGREKO.

In its efforts to encourage private investment, a liberalization of the sector regulations has been undertaken. Private producers have been part of the electricity generation process since 1985; however, production, transmission, and distribution were left under state monopoly, with these activities being managed by CIE since 1990.

With the adoption of a new Electricity Code in 2014, CIE's monopoly on transmission, distribution, and marketing of electricity was terminated.

Power generation is currently reliant to a significant degree on independent power producers (IPPs).

What is the applicable procurement process?

In Ivory Coast, the key principle is that any contract procured by the public sector is awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

In general, in the energy and infrastructure areas, public procurement is relevant where the Ivorian government, or a public entity, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset.

The relevant procurement legislation applies to certain public bodies, including central government departments, local authorities, police and fire authorities, various non-governmental bodies such as the Competition and Markets Authority. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

Investing in energy and infrastructure

In most cases, the public sector will need to publish a contract notice in the gazette and typically run one of the following procedures:

Open procedure – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the National Authority for the Regulation of Public Procurement (ANRMP) notice. Change and negotiations to the tender are not permitted.

Restricted procedure – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

Competitive dialogue – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer's bid.

Competitive procedure with negotiation – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

Financing energy and infrastructure

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.
Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector and any refinancing gains to be shared with the public sector.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in the Ivory Coast (including in relation to public-private partnerships) are:

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders;
- refinancing of the debt in operational projects; and
- asset financing – this is particularly relevant in the rail sector.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When there is a presumed violation of compliance requirements, the Capital Markets Authority (CREPMF) launches an investigation when it believes that there a potential violation of the rules and regulations.

The enforcement of investigations can be done at any time when the financial market authority considers there is a violation of law. The financial market authority can find information from different actors in the market (shareholders, parent companies and subsidiaries, of any legal or natural person having a direct or indirect relationship of interest with the stakeholders).

This investigation can result in sanctions.

What regulatory penalties may apply?

Also, the regional council, in application of article 30 of the appendix relating Composition, Organization, Functioning and attributions of the CREPMF, can impose a disciplinary, financial and administrative sanction for any action, omission or maneuver that would be contrary to the general interest of the financial market and its proper functioning and/or prejudicial to the rights of savers.

The CREPMF does not have the power to impose criminal sanctions, but it does have the power to pronounce:

- pecuniary sanction;
- administrative sanction; and
- disciplinary sanction.
When there is violation of law, the financial authority can apply pecuniary sanctions (fines), administrative sanction (withdrawal or suspension of authorization) and disciplinary sanction. This sanction does not prevent the application of criminal penalty.

Those sanctions are imposed without prejudice to legal sanctions which may be pronounced against their authors on the basis of a claim for compensation brought on an individual basis by aggrieved persons as a result of these conducts (appendix relating Composition, Organization, Functioning and attributions of the CREPMF, article 30).

**What criminal penalties may apply?**

According article 36 of the appendix relating Composition, Organization, Functioning and attributions of the Regional Council of the Public Savings and Financial Markets, regulators have powers to impose criminal penalties in certain cases, to any person who, intentionally:

- does not respect the restriction, suspension, or prohibition of professional activity that has been notified to him by the Regional Council;
- spreads false information in the public about the stock market and its products;
- performs a stock market maneuver aimed at hindering the regular operation of the market;
- overrides a decision to reject an application or withdraw a visa taken by the Regional Council;
- infringes the monopolies of stock exchange trading and securities accounts vested in management and intermediation companies;
- commits an insider trading.

In addition, in the case of a legal person, the *de jure or de facto* managers will be liable to the same proceedings if they become aware of these acts.

The financial conduct authority can't apply criminal penalties. They may just apply the sanctions specified above. Criminal penalties are applied by national court.

**Tax**

**Tax issues**

**Are stamp, registration, transfer or other similar taxes applicable?**

**Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?**

Treasury bills and Treasury bonds incomes are tax-free throughout the territory of the Member States of the WAEMU. But for non-members, the tax rates are different from one country to another. In Ivory Coast, the common tax rate one securities income is equal to 12%. Bonds with issuance of minimum five years have a tax rate of at least 6%.

**Advance of loan**

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

**Transfer or assignment of a debt under a loan**

A written instrument transferring or assigning a debt under a loan is chargeable depending on the deed. So, if it is a private act, it is chargeable according to the operation. If it is a notary public's act, it is chargeable at a fixed price (2,000-90,000) or proportional tax (0.5%-12%). If it is a bailiff's act, it is chargeable according to the operation. The act could be chargeable to 10% if the act concerns business capital.
Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There is no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security.

However, most security interests created must be registered at Land Property and Mortgage Office of Ivory Coast.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

ISSUE OF DEBT SECURITIES

Bearer bonds

The issuance of a debt security in Ivory Coast normally requires the bearer to register.

However, no specific rate is provided for when the debt security is issued.

Registered bonds

No specific rate is provided.

TRANSFER OF BONDS

Bearer bonds

In Ivory Coast, all transfers, assignments and other transfers of receivables for pecuniary interest are taxable at a rate of 1%.

Registered bonds

A written instrument transferring a debt security which is a registered bond is, in principle, chargeable. There are several types of stamps applicable. The written instruments transferring bonds are taxed in 1%.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Secured lenders and secured debt security holders take priority over tax authorities on enforcement of security.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

In Ivory coast, withholding tax is applicable on interest payment under a loan.

If so:

What is the rate of withholding?

Foreign banks are subject to 18% tax on loan interest.
What are the key exemptions? For example, is there an exemption for interest payments to banks, to local lenders/debt security holders, on listed debt, to lenders/debt security holders entitled to the benefit of a double tax treaty etc.?

The exemptions listed by the Ivorian tax code are:

- some capital depreciation that are allowed after request;
- interest on amounts recorded in savings bank books;
- structures working in microfinance;
- current accounts;
- cooperatives;
- interest and loan issued by the State or the national investment bank;
- loans issued by the public treasury; and
- interest on loans from certain companies subject to income tax on movable capital.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

The lender will be taxed on interest payments under a loan in the jurisdiction of the borrower.

The entity receiving interests is supposed to record and declare it under their corporate income tax heading.

There is no withholding tax on interest for natural persons.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes, it will.

Suppression of income tax on interest on Treasury bills and bonds taken out by natural persons (Article 12).

The General Tax Code subjects the income from non-bond loans to the tax on receivables (IRC) and fixes the applicable rates as follows:

- 10% for bonds and bonds of 3, 6, 9 or 12 months;
- 5% for those whose maturity is 3 to 5 years.
Japan

Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

To issue debt securities (corporate bonds), the issuing entity must determine the offering terms and approve them through the relevant corporate organ as designated by the Companies Act.

An offer of debt securities is categorized as either a private placement or a public offering under the Financial Instruments and Exchange Act. If an offer is regarded as a public offering, the issuer is required to file a Securities Registration Statement through the Electronic Disclosure for Investors' NETwork (EDINET) before solicitation and deliver a prospectus to those who wish to purchase the securities. Solicitation is allowed only after a waiting period (15 days in principle) from the filing of the Securities Registration Statement.

However, the waiting period may prevent a company from issuing the securities in a timely manner. For this reason, a company issuing bonds by way of a public offering often adopts the Shelf Registration Scheme instead of filing the Securities Registration Statement. This permits an issuer which has submitted the Shelf Registration Form in advance to issue and allocate bonds immediately after submission of Shelf Registration Supplements.

Once the company files a Security Registration Statement or submits a Shelf Registration Form, periodic disclosure obligations including the issuance of an Annual Securities Report is triggered. Conversely, if an offer is regarded as a private placement where only qualified institutional investors (QIIs) or 49 or fewer non-QIIs are solicited within a six-month period, the periodic disclosure obligations are not triggered.

What are common issuing methods and types of debt securities?

The following are common types of debt securities:

- corporate bonds;
- convertible corporate bonds;
- equity-linked bonds; and
- asset-backed securities.

The most common debt securities are corporate bonds issued pursuant to the Companies Act.
What are the differences between offering debt securities to institutional / professional or other investors?

Offers exclusively to qualified institutional investors (QIIs) will constitute a private placement and will not trigger periodic disclosure obligations, provided that the securities allocated to such QIIs will not subsequently transfer to non-QIIs.

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When is it necessary to prepare a prospectus?

As noted previously, it is necessary to prepare and deliver a prospectus before or upon the allocation of debt securities in a public offering. The prospectus may be delivered in electronic form with the consent of the recipients of the prospectus.

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What are the main exchanges available?

The Tokyo Stock Exchange is the primary exchange in Japan. More than 20 convertible bonds are listed on the Tokyo Stock Exchange as of March 2017.

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Is there a private placement market?

Private placements of debt securities are common in Japan. Private placement bonds issued by Japanese and overseas companies may be listed on the TOYKO PRO-BOND Market.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

The Companies Act stipulates that a company issuing debt securities must appoint a bond administrator unless either:

• the minimum par value of each bond is JPY100 million or more; or
• the number of bondholders is 49 or less.

The bond administrator, which is appointed among banks or other financial institutions, will manage the bonds on behalf of the issuers and owe a duty of care towards the bondholders. In practice, most bonds do not have bond administrators.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

The establishment of a fund, the offering of fund interests and the operation of a fund are regulated under the Financial Instruments and Exchange Act (including applicable secondary legislation such as any relevant Cabinet Order and Cabinet Office Ordinance) and subject to regulatory oversight by the Financial Services Agency.
Collective investment schemes

The regulations apply to the offering of interests in collective investment schemes, which include the following interests (subject to certain specific exceptions detailed in relevant legislation):

- the right to receive dividends of profits or a distribution of assets arising from businesses by way of cash, securities and/or bills of exchange contributed by equity owners (equity partners); and
- the rights emanating from a partnership contract, an anonymous partnership agreement, an investment limited partnership agreement, a limited liability partnership agreement or the membership rights of an incorporated association.

What are common fund structures?

Common fund structures include:

- a partnership created by a partnership contract under the Civil Code;
- a partnership created by an anonymous partnership agreements under the Commercial Code;
- an investment limited partnership created by an investment limited partnership agreement under the Investment Limited Partnership Act; and
- a limited liability partnership created by a limited liability partnership agreement under the Limited Liability Partnership Act.

What are the differences between offering fund securities to professional / institutional or other investors?

The main difference between offering fund interests to professional/institutional or other investors is whether certain exemptions to the broker license requirement are applicable.

Under the Financial Instruments and Exchange Act of Japan, a license is required to solicit the sale of fund interests to Japanese investors. However, a commonly used exemption, known as the Article 63 Exemption, exempts an issuer from the broker license requirement provided that a standard notification to make use of the exemption is made. Due to the availability of the exemption, foreign companies often offer fund units to Japanese investors without the requisite broker license.

The basic requirements for the application of this exemption are as follows:

- The foreign issuer must offer the fund units by themselves.
- At least one Japanese qualified institutional investor (QII) must be involved in the issue.
- If the pool of Japanese investors includes non-QIIs, then such non-QIIs must be eligible to be solicited (so-called “Eligible non-QIIs”) and there must be no more than 49 eligible non-QIIs.

In addition, professional investors may also be exempt from other restrictions (as detailed below).

If the Article 63 Exemption applies, the general partner (GP) must fulfill certain obligations including the following:

- the creation and annual filing of a business report with the regulatory authority;
- maintaining proper accounting books and business records; and
- making filed information available for public inspection at each business location or by making the information available on a website.
Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

The general partner (GP) of a fund is also subject to certain conduct restrictions and obligations including the following:

- a prohibition on the provision of fraudulent information in connection with the solicitation or sale of financial instruments;
- a prohibition on the indemnification of its customers against losses incurred as a result of the investment;
- a prohibition on licensing any third party to use the GP's name or conduct the GP's business operations;
- a prohibition on providing a definitive judgement on the investment;
- certain advertising restrictions;
- disclosure obligations before and upon the sale of financial instruments;
- a duty of care and loyalty to its customers;
- a duty to conduct solicitation and sales activities in accordance with the customer's investment skills, history, purpose, and financial status;
- a prohibition on soliciting and selling fund interests to investors where a segregation of the invested capital is not secured;
- a duty of good care in investment management; and
- a duty to provide a written investment report to customers.

Some of the requirements above may not apply when engaging with professional investors.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

An offer of fund interests is categorized either as a private placement or a public offering under the Financial Instruments and Exchange Act. A public offering of fund interests refers to an acquisition of fund interests by 500 or more investors as a result of solicitation. In a public offering, the Securities Registration Statement via the Electronic Disclosure for Investors' NETwork (EDINET) requires the offeror to deliver a prospectus to investors who wish to purchase the securities prior to solicitation. When the company files the Security Registration Statement or submits the Shelf Registration Form, periodic disclosure requirements will be triggered. These obligations include the filing of an Annual Securities Report.

The marketing of funds is regarded as a sale of financial instruments under the Act on Sales of Financial Instruments. The act requires a firm marketing funds to establish a solicitation plan which ensures the appropriateness of sales activities and to fulfil a firm's duty to disclose to investors any risk pertaining to the funds.

The execution of agreements to purchase fund interests is designated as a transaction requiring the use of anti-money laundering measures. In particular, the firm marketing the funds must confirm the investor's identity, objective in transacting, business scope and the identity of any substantial controllers (i.e. a shareholder owning 25% or more of all shares). Records confirming this information must be kept for seven years. The parties must also report any suspicious transaction which might involve criminal proceeds to the relevant administrative agency.

Are there any restrictions on managing a fund?

For an Investment Limited Partnership, general partners must ring-fence the invested amounts and any other assets invested in the fund.
from their own invested amounts and/or assets.

The Financial Instruments and Exchange Act requires a fund manager to prepare documents detailing the fund’s investment activity. The specific types of required documents vary depending on the structure of the fund and the license it holds.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Under the Financial Instruments and Exchange Act, a person entering into a derivatives contract for financial instruments (such as securities and currencies), financial indicators (such as exchange rates) or certain credit derivatives must be registered with the Prime Minister.

In addition, under the Commodity Derivatives Act, derivatives contracts for commodities (such as crude oil and gold) or related commodity indices as well as activities related to the brokerage, intermediation or agency of such commodity derivatives must only be conducted by a duly licensed entity (licensed by the Minister of Agriculture and the Ministry of Economy, Trade and Industry, in principle).

The requirement for sellers to explain the risk of the derivatives at issue to potential customers when soliciting derivative contracts is an important regulation under the Financial Instruments and Exchange Act concerning derivatives.

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What are common types of derivatives?

The over-the-counter derivatives market is limited when compared with the market in the UK or US.

The market in derivatives has increased in recent years and derivative contracts are entered into in Japan for a range of reasons including hedging and speculation. Derivatives may be traded over-the-counter or on an organized exchange.

Common types of derivatives are:

- forwards;
- futures;
- options;
- swaps; and
- credit derivatives.

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Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis of 2007–2008, derivatives and particularly over-the-counter (OTC) derivatives have attracted significant regulatory attention.

A notable transparency initiative introduced in 2012 for the purposes of the regulation of OTC derivatives is the requirement to use an electronic trading system for certain types of OTC derivatives transactions.

As of September 2016, new regulations under the Financial Instruments and Exchange Act require financial institutions to collect and post collateral for OTC derivative transactions which do not use a central clearing house to effect the transaction. This requirement aims to enhance the security of large derivative transactions by limiting the instances of default.

Based on the recent amendments to the Financial Instruments and Exchange Act in May 2019, which are effective as of June 2020, derivative transactions backed by cryptocurrency defined under the Payment Service Act are also subject to registration requirements.
Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is a regulated activity. In general, a lender will need to obtain a moneylending business license or certain other licenses such as a banking license. Though the application of the Money Lending Business Act (for instance, the requirement to hold a moneylending business license) to a foreign company lending money from outside Japan to a party inside Japan is not very clear, it would be prudent for a foreign company to obtain a moneylending business license.

To obtain a moneylending business license, an entity must satisfy certain requirements. For instance, a company must:

- have minimum net assets of JPY50 million;
- have at least one office in Japan;
- have at least one director with at least three years of experience in moneylending operations;
- not conduct any operations against public benefits;
- in respect of each office it operates, have ‘full-time chiefs of moneylending operations’ who have passed a required examination and registered with the relevant regulatory authorities (the ratio of the ‘number of chiefs of moneylending operations’ against the ‘number of persons engaged in money lending operations’ must be 0.02 or more); and
- in respect of each office it operates, have at least one full-time director or employee who has at least one year of experience in moneylending operations.

Certain of the requirements above can restrict the ability of a foreign company to obtain a moneylending business license.

Borrowing

Borrowing is generally not regulated.

What are common lending structures?

Lending in Japan can be structured in a number of different ways to include a variety of features, depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or a syndicated basis (multiple lenders each providing parts of the overall facility). Facilities can be divided into tranches for instance, with senior and mezzanine loans.

Syndicated facilities in tranches by their nature involve more parties (such as agents, trustees and senior lenders and/or mezzanine lenders), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate or an independent agent taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific funding objectives. Types of loans include term loans, working capital loans, bridge loans, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can vary between:
• a term loan, provided for an agreed period of time;
• a revolving loan or commitment line, provided for an agreed period of time, which may be used multiple times up to the maximum outstanding amount agreed;
• an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
• a bridge loan intended for use in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can be:

• committed, meaning that the lender is obligated to provide the loan if certain conditions are fulfilled; or
• uncommitted, meaning that the lender has discretion as to whether or not to provide the loan.

In most cases, loans are made available as committed facilities.

Loan repayment

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or on a scheduled basis (usually in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

There are no notable differences between lending to institutional or professional companies such as qualified institutional investors (as defined in the Financial Instruments and Exchange Act) and lending to other companies.

Lending to individuals is subject to the requirement that the ratio of the outstanding amount of total lending against an individual’s annual salary must be one third or less, unless certain exemptions apply (for instance, relating to the purchase of real estate by an individual). This is referred to as the Total Volume Control.

Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of Japanese law.

For instance, it is possible to appoint an agent (dairenin) to act on behalf of other parties or a trustee (jutokusha) to hold rights and other assets on trust for trust beneficiaries (juekisha), such as lenders or secured parties.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to several Japanese laws, including the Interest Rate Restriction Act and the Civil Code. The maximum interest rate permitted is between 15% and 20% depending on the lending amount. The maximum rate allowed
for liquidated damages in the case of the borrower's default is 1.46 times the applicable maximum interest rate allowed.

## Specific types of lending

When lending to individuals, the Total Volume Control which limits the amount that may be outstanding by reference to an individual's salary will apply. For this purpose, the lender is required to use credit information held by a designated credit bureau to check the individual borrower’s financial credibility.

## Standard form documentation

The Japan Syndication and Loan-Trading Association has standard form documentation often used by Japanese lenders. Foreign lenders typically use their own standard form documentation.

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### Are there any other notable risks or issues around borrowing?

There are none to highlight for the summary purposes of this site.

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## Giving and taking guarantees and security

### Are there any restrictions on giving and taking guarantees and security?

Some key areas affecting giving and taking of guarantees and security are as follows.

#### Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the powers of directors that would otherwise restrict the provision of security. For instance, a decision to borrow and/or to give a guarantee in respect of a significant amount must be made by the board of directors and may not be entrusted to any individual director. Furthermore, a transaction giving rise to a conflict of interest (such as a guarantee by a company for the obligations of its directors) must be approved by the board of directors, with the director in conflict abstaining from the vote on the relevant resolution. Each director of a company owes the duty of care of a good manager and a duty of loyalty to the company. As such, a director must be able to demonstrate that adequate corporate benefit is derived from the giving of a guarantee or security.

#### Insolvency

Guarantees and security may be at risk of being set aside under Japanese insolvency laws if they are:

- provided with little or no consideration within six months of or after the company’s suspension of payment;
- provided after the company becomes unable to pay its debts generally and the creditor is aware of the suspension of payment or the company's inability to pay its debts generally; or
- provided after the application for commencement of bankruptcy proceedings and the creditor is aware of such application.

Guarantees and security may also be challenged on other grounds relating to insolvency.

#### Provision of profit

A company may not provide any benefit to its shareholders in relation to or in connection with the exercise of shareholder rights by a shareholder.

### Obligation of a lender taking a guarantee from an individual
A lender taking a guarantee from an individual is required to use credit information held by a designated credit bureau to verify the individual's credit worthiness. However, the Total Volume Control lending requirement (that the amount of total lending against the individual's annual salary must be one third or less) does not apply to guarantees given by an individual.

**Upstream guarantees**

Upstream guarantees are possible. However, if there is no adequate consideration for or corporate benefit derived from such guarantee, a breach of the directors' duties would be an issue.

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**What are common types of guarantees and security?**

**Common forms of guarantees**

Two types of guarantees may be given.

**(NORMAL) GUARANTEE (HOSHO)**

A guarantor has the right of defense of demand which permits a guarantor to require that the beneficiary first demand performance by the principal obligor. The further right of defense of reference permits a guarantor to require that the beneficiary first enforce against the principal obligor's property by demonstrating that the principal obligor has sufficient financial resources to satisfy the debt and that the satisfaction of the obligation could be easily performed by enforcing against the principal obligor.

**JOINT AND SEVERAL GUARANTEE (RENTAI-HOSHO)**

A joint and several guarantor does not have the right of defense of demand or the right of defense of reference. Under this type of guarantee, the guarantor owes the same obligation as the primary obligor.

Under the amended Civil Code that is effective as of 1 April 2020, regardless of the type of the principal obligation, if the guarantor of such obligation is an individual, the amount guaranteed by such individual must be subject to a clear cap. As a result, in the case of a guarantee of any type of principal obligation, including tenant's obligation under a lease agreement or purchaser's obligation under a continuous sales and purchase agreement, as long as an individual is the guarantor, the guarantee must specify the maximum amount of the guarantor's obligation. Otherwise, such individual guarantee would be invalid.

**Common forms of security**

Three basic types of security interest can be created under Japanese law.

**(MORTGAGE (TEITOUKEN)**

A mortgage may be created on rights to real property and certain other types of property such as automobiles, aircraft and factories.

**(PLEDGE (SHICHIKEN)**

A pledge may be created on an asset that can be assigned to others such as chattels, real property and rights. For a pledge (other than a pledge on right without a deed) to be effective, the asset must be 'delivered' (hikiwatashi) to the pledgee. In the case of a pledge on movable property, the pledgee must continuously possess the pledged asset for the pledge to remain valid.

**(SECURITY BY WAY OF TRANSFER (JOTO-TAMPO)**

A security by way of transfer is not a statutory security. It is commonly used to avoid the potentially stringent requirements for a pledge on a movable property, in particular, that the pledgee must continuously possess the pledged asset. A security by way of transfer enables the pledgor to possess and use the pledged asset even during the security period.

_Last modified 5 Dec 2019_
Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee must be in writing.

There is a further risk that a guarantee may be set aside if improperly obtained, for instance, by undue influence. It is best practice for a party taking the benefit of a guarantee to take steps to avoid claims of undue influence by, for example, requiring the guarantor to obtain independent legal advice.

Giving or taking security

Once granted, security must be properly perfected. Perfection formalities may include:

- ‘delivery’ of the pledged assets to the security holder (e.g. a pledge on a movable property);
- registration of the security (e.g. a mortgage on a real property); and
- notification to the obligor of the right pledged.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Financial Instruments and Exchange Act (Kinyu Shohin Torihiki Hou) (securities transactions)

Foreign Exchange and Foreign Trade Act (Gaikokukawase oyobi Gaikokuboeki Hou) (foreign transactions)

Payment Services Act (Shikinkessai ni kansuru Houritsu) (fund transfer business other than banking)

Trust Act (Shintaku Hou) (trusts)

Consumer credit

Consumer Contract Act (Shohisha Keiyaku Hou) (consumer contracts)

Mortgages

Act on Securitization of Assets (Shikin no Ryudoka ni kansuru Houritsu) (securitization of assets using special purpose companies or special purpose trusts)

Secured Bonds Trust Act (Tanpotsuki Shasai Shintaku Hou) (trusts relating to secured bonds)

Mortgage Securities Act (Teito Shoken Hou) (mortgage securitization)

Corporations

Companies Act (Kaisha Hou) (company)
Banking Act (Ginko Hou) (banking)

Money Lending Business Act (Kashikingyo Hou) (moneylending business)

Funds and platforms

Limited Partnership Act for Investment (Toshijigyouyugensekininkumiaikeiyaku ni kansuru Houritsu) (partnerships to conduct investment business)

Act on Investment Trusts and Investment Corporations (Toshishintaku oyobi Toshihojin ni kansuru Houritsu) (investment in securities using investment trusts and investment corporations)

Limited Liability Partnership Act (Yugensekinjigyoukumiaikeiyaku ni kansuru Houritsu) (limited liability partnerships)

Other key market legislation

Interest Rate Restriction Act (Risoku Seigen Hou) (interest rate)

Act on Prevention of Transfer of Criminal Proceeds (Hanzai niyoru Shueki no Itenboshi ni kansuru Houritsu) (anti-money laundering)

Regulatory authorization

Who are the regulators?

The Financial Instruments and Exchange Act delegates control over the disclosure of information related to securities and the regulation of securities to the Financial Services Agency, an external bureau of the Cabinet Office.

The Prime Minister has regulatory authority to order a financial instruments business or an intermediary service to:

- improve its operations;
- suspend its businesses; or
- rescind its registration.

What are the authorization requirements and process?

Any firm engaged in financial instruments business or the provision of financial instruments intermediary services must register with the Prime Minister.

The activities of a firm engaged in financial instruments business includes the sale and purchase of securities, derivatives transactions, public offerings and private placements. A firm providing financial instruments services typically conducts intermediary services in connection with the sale and purchase of securities, public offerings or private placements.

A registration tax is payable upon submission of an application for registration. The fee is ¥150,000 for registration of a financial instruments business and ¥90,000 for registration of a financial instruments intermediary service.

When an application for registration is filed, the regulatory authority records certain mandatory information in a central registry.

What are the main ongoing compliance requirements?

Registration does not require regular renewal.
Firms conducting financial instruments business and providers of financial instruments intermediary services are subject to compliance with general legal and regulatory requirements including disclosure obligations. Failure to comply with applicable law and regulation may result in the revocation of the firm’s registration.

Minimum capital requirements apply to financial instruments businesses. A first-class financial instruments business must maintain minimum capital of ¥50 million while a second-class financial instruments business must maintain a minimum of ¥10 million in capital. There are no minimum capital requirements for providers of financial instruments intermediary services.

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What are the penalties for failure to be authorized?

A person or a corporation undertaking a regulated activity without prior registration is deemed to have committed a criminal offence and is subject to imprisonment and/or a fine.

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Regulated activities

What finance and investment activities require authorization?

Generally

An individual or a firm cannot undertake certain financial and investment business activities unless duly authorized.

The Banking Act requires a license from the Prime Minister for the conduct of banking activity. Banking activity includes the acceptance of deposits or instalment savings, the administration of loans and bill discounting.

A financial instruments business or financial instruments intermediary service cannot operate without prior registration. Activities which fall within the scope of a financial instruments business and providing a financial instruments intermediary service includes the sale and purchase of securities, market transactions in derivatives, public offerings and private placements. Similar activities conducted by a financial instruments business operator or a registered financial institution also require authorization.

Consumer credit

A financial instruments business lending money or an intermediary service providing for the borrowing of money must register under the Money Lending Business Act. The Prime Minister or a competent prefectural governor has the authority to order a lending business to improve its operations, suspend its business altogether or rescind its registration.

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Are there any possible exemptions?

Registration is not required for a non-resident financial instruments businesses or financial instruments intermediary service providers conducting investment advisory or investment management business in foreign countries, in respect of certain financial instruments businesses.

A person or corporation conducting a private placement to qualified institutional investors or a fund manager consisting of qualified institutional investors may notify the Prime Minister in advance of the placement in lieu of registration.

A lending business or intermediary service is exempt from registration for the following activities under the Money Lending Business Act:

- non-business loans;
- loans subsidiary to the sale, transportation, storage and intermediation of sale of goods; and
- loans by a business operator to its employees; and
Do any exchange controls or other restrictions on payments apply?

Strict regulations are not generally imposed on foreign direct investment in Japan. However, in exceptional cases, pre- or post-acquisition notices may be required under the Foreign Exchange and Foreign Trade Act.

The Foreign Exchange and Foreign Trade Act applies to the following four categories of investment:

- inward direct investments conducted by a foreign investor;
- capital transactions;
- payments to and from foreign countries; and
- foreign trade (import and export).

Capital transactions, payments to and from foreign countries and foreign trade are regulated concurrently by the Ministry of Finance and the Ministry of Economy, Trade and Industry. Foreign trade transactions are regulated exclusively by the Ministry of Economy, Trade and Industry.

Based on the recent amendment to the Foreign Exchange and Foreign Trade Act in August 2019, the category of “restricted business sectors” requiring off-shore investors to make a prior filing with the Bank of Japan has been expanded to include, among others, the information and communication technology sector such as data processing service and internet user support services.

In addition, Japan's Cabinet approved and submitted to the Diet a draft bill of further amendments to the Foreign Exchange and Foreign Trade Act in October 2019. Under these amendments, the current pre-filing threshold of 10% for foreign investors making investments in Japanese listed companies in the “restricted business sectors” will be reduced to 1%. However, certain exemptions from this prior-filing requirement will be introduced under the amendments. For instance, proprietary trading by foreign securities firms and transactions by foreign banks or insurance companies could generally be exempted from pre filings.

Business operators, such as banks, insurance companies, financial instruments businesses, trust companies, lending businesses or other operators specified by the Act on Prevention of Transfer of Criminal Proceeds must, in respect of certain transactions, confirm:

- the purpose of a transaction;
- the identity of the relevant customer;
- the occupation or business of the relevant customer; and
- the identity of persons substantially controlling the customer’s business.

What are the rules around financial promotions?

Rules

When a financial instruments business enters into a contract for the sale and purchase of securities, a derivatives transaction, a public offering, a private placement or certain other types of transaction, specified disclosure requirements must be met before and upon execution of the transaction contract. For example, a financial instruments business must deliver explanatory documents to a customer and provide information to enable a customer to make an informed investment decision.

Exemptions

When a financial instruments business executes a contract for the transactions referred to above with professional investors, certain exemptions apply. For instance, the requirement to provide risk information when soliciting business and the prohibition on re-solicitation do not apply.
Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common forms of legal entities in Japan are:

- the Kabushiki Kaisha (KK), which is a joint-stock company; and
- the Godo Kaisha (GK), which is similar to a limited liability company.

While the KK is the most traditional and commonly used type of corporate entity in Japan, GKs are becoming increasingly common due to their streamlined structure which provides more flexibility in corporate governance and management decisions, lower annual costs and decreased regulation.

For both KKs and GKs, the liability of members is limited to the amount of their contribution. There are no minimum capital requirements which apply to KKs and GKs generally, unless they conduct specific types of activity which are otherwise subject to further regulation.

Funds

An Investment Limited Partnership (LPS) formed under the Limited Partnership Act for Investment is the most commonly used investment vehicle. An LPS consists of:

- one or more general partners (GPs) who manage the fund and assume unlimited liability with respect to debts owed by the fund; and
- one or more limited partners (LPs) who do not engage in management of the fund, but whose liability is limited to the amount contributed by the LPS.

An LPS is formed by agreement between its GPs and LPs. It may invest only in the types of investment targets specified in the Limited Partnership Act for Investment. Furthermore, an LPS may not invest a majority of its contributed assets in shares, options or other securities issued by foreign companies. For this reason, a limited partnership formed outside of Japan (such as in the Cayman Islands) is typically used if the fund is targeted towards non-Japanese entities.

An LPS does not pay corporate tax on its investment income because it is treated as a pass-through entity. Taxes are instead levied on each partner.

Is it possible to conduct lending or investment business through a branch or establishment?

Lending business

Yes, a foreign-established company may conduct lending business through a branch registered in Japan.

Investment business

Yes, a foreign-established company may conduct investment business through a branch registered in Japan.
FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

Peer-to-peer (P2P) lending is considered a type of ‘cloud funding’, which encompasses various types of transactions including, among others, contribution, buying and selling and capital investment. P2P lending is a lending system available on an online platform that matches individual investors or lenders with borrowers, such as small and medium-sized enterprises or individuals. P2P lending reduces funding and investment costs through the simplification and automation of lending procedures. Additionally, because investors can make a series of smaller investments through P2P platforms, they are able to diversify their investment risks.

HOW PRACTICAL IS PEER-TO-PEER LENDING IN JAPAN?

A business lending money or an intermediary service providing for the borrowing of money, which includes lenders and P2P platform providers, must register under the Money Lending Business Act. A partnership agreement (Tokumei-Kumiai) scheme may be used where registration is not practicable for lenders; they invest in platform providers as silent partners instead of lending. It should be noted however that in addition to the platform provider being required to register as a lending business, it would also need to register as a Financial Instruments Business for the sale of its equity interests under the Financial Instruments and Exchange Act.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (e.g. in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known...
within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

No license is required to manage or use blockchain technology in Japan because it consists only of a distributed computer network system and distributed ledger system.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

Smart contracts are likely to be used in various industries to conduct business, including by an investment fund raising funds by issuing electronic tokens to investors and using the funds raised to invest in target assets or businesses at the direction of the majority of investors. The investors are then eligible to receive dividends in proportion to the amount of the tokens in their possession. This investment fund programs the aforementioned process (fundraising-investment-dividend) in advance through implementation of the fully-automated smart contract mechanism.

**WHAT ARE CRYPTOCURRENCIES?**

Cryptocurrencies such as bitcoin or ethereum are digital, virtual currencies generated using blockchain technology.

In Japan, cryptocurrencies are not considered traditional legal currencies, such as US dollars or Japanese yen. In 2014, Mt. Gox, which was then the world’s largest virtual currency exchange, filed for bankruptcy protection in Japan due to misappropriation of customer assets by Mt. Gox operators. Recognizing the risk of virtual currency abuse by business operators for money laundering or other purposes, both the Payment Services Act (PSA) and the Act on Prevention of Transfer of Criminal Proceeds (APTCP) were amended on 25 May 2016 to address this concern. Furthermore, incidents involving loss of users’ cryptocurrencies have continued to arise following the Mt. Gox incident. In light of this situation, the PSA was further amended in May 2019 to strengthen the cryptocurrency regulations for user protection purpose.

The PSA:

- provides a definition of cryptocurrency;
- requires business operators of ‘Virtual Currency Exchange Services’ to register with the Financial Services Agency (FSA); and
- requires those Virtual Currency Exchange Services business operators to comply with various obligations in order to protect customers.

These amendments were seen as significant legal developments for the FinTech sector in Japan.

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

An ICO can be considered a form of crowdfunding, which typically operates by raising funds through the issuance of digital tokens. This funding method is often used by startup FinTech ventures. An ICO is similar to an Initial Public Offering (IPO); however the main difference
is that investors typically do not have any voting rights or control rights similar to those associated with shares issued in an IPO. Therefore, company directors are free to manage their companies without having to worry about direct interference from shareholders.

In Japan, there are currently only a few instances of fund raising using ICOs. A unique service called 'VALU' has had more success recently in Japan. VALU is provided by a FinTech company whose target users are individuals rather than companies. On the VALU platform, individual users are provided their own ‘total market price’ which is automatically calculated based on their number of followers on social networking sites such as Facebook or Twitter, and these individual users can issue unique tokens to investors similar to the way companies issue shares to investors for funding.

It is also expected that Japanese financial regulations or cryptocurrency regulations will apply to ICOs depending on their structure. For example, if a company sells a cryptocurrency (as defined in the PSA) in the course of an ICO, registration is required and relevant restrictions would be imposed on the company in accordance with the PSA and the APTCP.

Under the amendments to the Financial Instruments Exchange Act in May 2019, it is now clear that tokens having the feature of a ‘security’ (the so-called ‘Security Token’) is classified as a ‘Type 1 security’ which is the most liquid type of securities consisting of shares of stocks, corporate bonds and debentures, share options, etc. Therefore, the issuance of Security Tokens is clearly subject to the securities disclosure requirement that mandates the filing of a Security Registration Statement prior to the offering of such tokens to the prospective investors, unless a private placement exemption applies.

Artificial intelligence and robo advisory systems

Automated advice tools known as ‘robo advisors’ have been introduced gradually as part of asset maintenance or investment management services. Robo advisors can provide advisory services to a wider range of individuals through personalized data analysis, and are comparable to those advisory services offered to high-net-worth clients and traditionally provided by private bankers. Investment advice services provided by robo advisors include portfolio selection, investment management and intermediary services, among others. Robo advisory providers must register as a financial instruments business and satisfy capital and organizational requirements in accordance with the Financial Instruments and Exchange Act.

Data analysis and cloud computing

The situation is the same as in England and Wales. Cloud computing enables delivery of IT services through internet-based tools and applications and cloud-based storage makes it possible to save masses of data on remote servers, accessible through the internet. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Financial Services Agency (FSA) is the Japanese governmental authority tasked with regulating companies dealing in financial businesses, which would include FinTech businesses. There are many types of FinTech products currently available, and various types of laws or regulations may apply to such products, depending on their nature and conditions. There are three main laws, among others, which govern FinTech products:

- the Financial Instruments Exchange Act (FIEA);
- the Payment Services Act (PSA); and
- the Act on the Prevention of Transfer of Criminal Proceeds (APTCP).
Financial Instruments Exchange Act (FIEA)

Financial business activities such as the sale or management of securities or financial instruments are subject to FIEA, which has two main categories of requirements: filing requirements and registration requirements. However, it is still unclear whether FinTech products such as cryptocurrencies are deemed 'securities or financial instruments' to be regulated by FIEA. If FIEA applies, a company dealing in FinTech products would be required to file a Securities Registration Statement and other periodical reports with the FSA as part of its filing requirements, and would also be required to obtain a certain form of registration from the FSA as its registration requirement.

Payment Services Act (PSA)

From May 2016, PSA clearly regulates virtual currency businesses, which would include the purchase, sale or exchange of virtual currency for Japanese customers. Virtual currency exchange companies which intend to enter into the Japanese market should consider the feasibility of both obtaining the registration from the FSA and complying with the restrictions on registrants.

The restrictions imposed by PSA include:

- segregation of customer funds and virtual currencies;
- provision of mandatory information to customers; and
- preparation and maintenance of transaction records for customers.

Act on the Prevention of Transfer of Criminal Proceeds (APTCP)

APTCP contains the Japanese anti-money laundering and counter-terrorist financing regulations. In general, APTCP requires financial institutions or virtual-currency business operators to implement a 'know-your-customer' process including the verification of customer identities and the maintenance of customer transaction records.

Electronic payments platforms and regulation of peer-to-peer lenders

Electronic Payment Platforms

The Banking Act and PSA regulate businesses which transfer funds between accounts regardless of whether or not such transfers would be considered payments; they require operators of a funds-transfer business to be registered or licensed. Because e-commerce markets such as Rakuten or Amazon use a payment process that contains a funds transfer, such payment platforms necessarily must be registered or licensed. However, as e-commerce market operators are given the authority to receive payments from online stores, whereby customer payments are made directly to these stores, such e-commerce market operators are not deemed to be transferring funds but rather only redeeming received funds. Construed in this manner, e-commerce market operators can avoid the registration obligation.

Peer-to-Peer Lenders

When peer-to-peer (P2P) lenders lend money as part of their business, even if such lenders are individuals, they must register as a money lending business. Since this would place an onerous registration requirement on lenders using P2P platforms, a partnership agreement (Tokumei-Kumiai) is used instead. Under this scheme, P2P investors do not lend but rather invest in platform providers as silent partners. An entity operating as a P2P platform provider, however, has an obligation to register as a money lending business and a financial instruments business under the Money Lending Business Act and the Financial Instruments and Exchange Act.

Regulation of payment services

In Japan, payment services are regulated mainly by two pieces of legislation:

- PSA regulates funds transfer services, issuance of prepaid payment instruments and virtual currency exchange businesses.
- Instalment Sales Act (ISA) regulates credit card issuers, merchant acquirers, payment service providers and merchants maintaining credit card services.

Funds transfer services are services provided by an entity other than a bank that involves the transfer of money in an amount of JPY 1 million or less, using a system to send money remotely. Where the amount transferred exceeds JPY 1 million, only banks are permitted to provide such service under the Banking Act. Credit card transactions are understood to be out of scope of the definition of funds transfer because such transactions are regulated by ISA instead. Prepaid payment instruments and credit cards share common features, such that
they are both used in exchange for providing goods or services; however, they differ in the credit directions, in that consumers grant credit to business operators when issuing prepaid payment instruments, while business operators grant credit to consumers in credit card transactions.

Payment service providers must register their business or notify their transactions to each governing agency and maintain their internal compliance systems depending on the type of payment service and the relevant legislation. Since PSA and ISA were established separately and are regulated by separate governmental agencies, it is sometimes unclear which regime would apply to new and unique service providers. Where it is unclear which regime a business needs to be registered under, confirmation should be obtained from the governmental agencies when establishing the business.

Application of data protection and consumer laws

The Act on Protection of Personal Information (APPI) regulates the processing of personal data in Japan. For matters under its jurisdiction, the FSA has issued guidelines regarding the application of APPI which should be followed in general.

APPI was amended recently and a new concept of ‘de-identified information’ was introduced, meaning it would not be necessary to obtain consent to transfer de-identified information to a third party and such de-identified information can be used for any purposes regardless of the purpose for which the personal information was originally obtained. This rule may accelerate FinTech innovation in Japan. On the other hand, the new APPI also introduced other regulations including a new concept for ‘sensitive information’ which requires that a business entity obtain prior consent to collect ‘sensitive’ information from a data subject.

In 2017 the Banking Act was amended to require that settlement agents for electronic settlement systems be registered as well as imposing a duty on settlement agents to explain certain matters (e.g. compensation) to consumers. The amendments are due to become effective in 2018.

Money laundering regulations

Under APTCP, business operators such as banks and money lending business operators should conduct identity verification procedures when lending money or intermediating such money lending while also creating and maintaining records regarding identity verification. If the transactions are not conducted face-to-face, business operators should ask the borrowers for a copy of their identity verification documents and send any documents related to the transaction to them as a transfer-prohibited postal item.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

GENERAL

The basic funding arrangements for FinTech companies are substantially different from those used by more traditional companies. Initial funding in a FinTech startup may be provided by family and friends of the founder or other high-net-worth individuals (known as business angels) who are interested in the firm’s business for seed financing, and after this initial stage, the FinTech startup would receive investments from venture capital (VC) as a series A round.

CROWDFUNDING

Crowdfunding is a method of funding for a new project or business to raise small amounts of capital from a large number of individuals through the internet. Firms using the crowdfunding system are subject to the Financial Instruments Exchange Act (FIEA) and must register with the competent authority. However, FIEA was amended on 23 May 2014 to relax registration requirements to promote the growth of crowdfunding businesses. There are two types of registration available under FIEA for crowdfunding businesses: Type I registration or Type II registration. Applicability of these registration types depends on the form of securities issued to investors. For example, Type I registration is required in the case of issuance of shares or share options through crowdfunding.

Venture capital and debt

VENTURE CAPITAL
Startups typically receive investments as equity from VC funds which are private equity investment vehicles. VC funds often invest in startups by purchasing preferred stock. Startups will enter into many complex agreements with VC funds, such as shareholder agreements and investment agreements. In addition, as described above, VC funds often demand preferred stocks which must be designed in line with the requirements of the Company Act and comply with certain processes in order to issue the preferred stocks legally.

VENTURE DEBT

It is rare for startups to raise funds such as venture debt, since such small or medium-sized firms do not have enough ability to make payments against the principal and interest on the debt. However, in some cases, startups can borrow money from banks or other companies as bridge financing until receiving investment from VC funds.

Warehouse and platform funding

Warehouse financing is available to businesses in Japan. Warehouse financing may be suitable for FinTech companies which own a portfolio of assets and are aware of any difficulty in raising money from capital markets.

Peer-to-peer (P2P) lending platforms such as maneo, which is the pioneer in this field in Japan, are also accessible to FinTech companies in Japan. However, because there are numerous restrictions on businesses conducting P2P lending services in Japan, including those arising under Money Lending Act and Financial Instruments and Exchange Act, P2P lending platforms are still not very popular in Japan.

Senior bank debt and capital markets funding

In general traditional banks take a stringent attitude towards lending money to venture-backed companies, but have become more open to lending money to FinTech startups.

Japan has both debt and equity capital markets which are accessible to businesses.

An Initial Public Offering (IPO) is one of the funding arrangements for the companies including FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the Tokyo Stock Exchange's market of the high-growth and emerging stocks. Recently more and more venture-backed companies conduct an IPO and FinTech startups are expected to do the same.

In line with current trends, FinTech startups are now raising finance by way of a rights offering, for example:

- QUQINE JAPAN, which manages a virtual currency exchange, raised about JPY 1.7 billion through a rights offering in 2016.
- Exchange Corporation K.K., which offers a credit service without the use of cards (Paidy), raised about JPY 50 million in 2014 and about JPY 1.5 billion in 2016 through a rights offering.
- More recently, Kyash K.K., which offers a free remittance application (Kyash), raised more than JPY 1 billion through a rights offering.
- freee K.K., which offers cloud accounting software, raised JPY 800 million in 2014 and JPY 4.5 billion in 2015 through a rights offering.

Incentives and reliefs

The National Diet (Japan's legislature) recently amended the Consumption Tax Law (Japanese Value Added Tax) such that the purchase of virtual currency became exempted in 2017. The Ministry of Economy, Trade and Industry issued its 'FinTech Vision', which provides their basic policies and recognition of issues. The Governor of Tokyo announced that the Tokyo Metropolitan Government is planning to reduce corporate taxes and subsidize personnel expenses to attract FinTech companies.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?
A loan can be sold on an individual basis or packaged with other loans as a portfolio grouped by certain underlying terms.

Occasionally, loans are transferred for syndication. For example, a single lender may make an initial loan due to time constraints and subsequently syndicate the loan by transferring part of the loan to other lenders.

**Assignment of rights**

Subject to contractual restrictions, the assignment of rights can be completed without the consent of the debtor. Partial assignments are also possible. Perfection can be accomplished through notice to or acknowledgement by the debtor on an instrument bearing a certified date (Notice or Acknowledgement).

**Assignment of contractual status**

Subject to the consent of the debtor, a total or partial assignment of a lender's contractual status, including any or all rights and obligations, is possible. A transfer of a revolving loan includes a transfer of the lender's obligation to lend money to the debtor and therefore cannot be accomplished only through the assignment of rights.

**Novation**

A novation results in the formation of a new contract between the continuing party and the transferee, while the transferor is released from all its obligations.

**Sub-participation**

Sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the purchaser taking on double the credit risk, being that of the seller and of the borrower. Some participation agreements have a triggering event (such as poor financial performance by the original lender) which requires a change to the sub-participation arrangements to effectively transfer the loan to avoid the new lender assuming the original lender's risk.

Loan transfers are commonly documented using standard form agreements made available by the Japan Syndicate and Loan-Trade Association and consisting of a master agreement for all transactions between the parties and an individual agreement for a specific transaction between the parties. In the case of any discrepancy between the two documents, the tailored individual agreement will prevail for the specific transaction. For more complex transactions, a more bespoke form of sale and purchase agreement is typically used. The form and content of the transfer documentation will depend on the nature of the loan assets.

**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise. Some of the key considerations include:

- **confidentiality** – whether the seller is allowed to disclose information relating to the loan to a potential purchaser;

- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;

- **undrawn commitment** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the purchaser or reduce claims made by the purchaser;

- **transfer mechanics** – whether there are any steps that must be taken to transfer the loan such as obtaining the consent of the borrower, a third party or both;

- **security** – whether the security is properly transferred to the purchaser (for example, a transfer of a revolving mortgage before the principal is fixed requires the mortgagor's consent);

- **perfection** – whether the transfer is perfected by way of notice or acknowledgement or by a registration of the assignment of the claim (in the case of a registration, the assignment is perfected against third parties at the time of the registration, while it is not
perfected against the debtor until the registered matters are notified to or acknowledged by the debtor); and

- allocation of repayments – the allocation of repayments between the seller and the purchaser depends on whether the borrower’s payment obligations accrue before or after the base date (which could be the date of the loan transfer) or if the borrower’s payments are actually made before or after the base date (the latter is often used for a transfer of problematic loans).

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in Japan varies by industry. The primary infrastructure industries are:

- economic infrastructure (energy, aviation, rail and telecommunications); and
- social infrastructure (including education and health).

Key sectors are detailed below.

Energy

Assets of the gas and electricity industries in Japan are privately owned. Generation, transmission, distribution and supply services are provided by companies in the private sector.

Telecoms infrastructure

Assets of telecommunications networks (such as mobile phones and television) in Japan are also privately owned by several different service providers other than the Japan Broadcasting Corporation/Nippon-Hoso-Kyokai (NHK) and Japan Post Holdings Co., Ltd. NHK is a publicly-owned broadcast business operator established by the Broadcast Act and under the jurisdiction of the Ministry of Internal Affairs and Communications. Japan Post Holdings Co., Ltd. is a mail and logistics operator which was recently partly privatized and listed on the Tokyo Stock Exchange.

Transport infrastructure

Assets of the transport industry in Japan are privately owned.

Social infrastructure

There are public and private schools and hospitals in Japan. The ownership of assets of these schools and hospitals depends on their public or private designation.

Water and wastewater services

Water and wastewater services in Japan are delivered by public organizations which own the relevant infrastructure assets. However, certain public organizations entrust the operation of such services to private companies.

Are there special rules for investing in energy and infrastructure?

Generally
There is no specific regulatory regime governing or restricting investment in energy or infrastructure projects in Japan over and above existing regulations for investors and funders more generally. However, a particular investment may be subject to legislative or regulatory control. For instance, foreign investors should comply with foreign exchange legislation under which foreign investment in certain business sectors (including electricity, gas, heat supply and telecommunications) requires a prior notification to enable authorities to determine whether such investment will be permitted. Further conditions relating to planning and implementation may require co-ordination with authorities.

**Energy**

The Electricity Business Act is the main legislation regulating businesses involved in the generation, transmission, distribution and sale of electric power. An electric business operator is required to obtain a business license or register with a competent authority, or may be required to file a notification prior to commencing operations. As for the business of distribution and sale of electric power, based on the amendments to the Electricity Business Act that became effective as of 1 April 2016, all business operators are able to engage in such business subject to registration, in contrast to the monopoly of the transmission business by certain utility companies. The operator of a power plant is required to meet certain technical requirements.

The Atomic Energy Fundamental Act, the Act on Compensation for Nuclear Damage and other specialized regulations govern the production and supply of nuclear power. A company which intends to have a power-generating nuclear reactor is required to obtain a business license from the Nuclear Energy Council and to maintain its facilities to meet certain technical requirements.

The Gas Business Act is the primary legislation regulating businesses involved in liquefied natural gas (LNG). The primary legislation regulating businesses involving liquefied petroleum gas (LPG) is the Act on Securing the Safety and Optimization of Transactions of Liquefied Petroleum Gas (the LPG Act). The LNG or LPG business operator is required to obtain the relevant business license or register with a competent authority prior to starting its business. The amendments to the Gas Business Act, that became effective as of 1 April 2017, enable all business operators to engage in the distribution and sale business involving LNG subject to registration, as is the case for business involving LPG (in contrast to the monopoly of transmission business involving LNG by certain utility companies). The LNG or LPG business operator is required to have appropriate safety regulations in place and submit those regulations to the competent authority.

**Telecoms infrastructure**

The Telecommunications Business Act is the primary legislation regulating businesses involved in telecommunications. A telecommunications business operator is required to obtain a business license and may be required to file a notification prior to starting its business. Television broadcasting is primarily governed by the Broadcast Act.

**Transport infrastructure**

The railway industry is primarily governed by the Railway Business Act. A railway business operator is required to obtain a business license. Railway operations are subject to government inspections, for instance, to ensure compliance with safety regulations.

**Other infrastructure**

The operation of schools is primarily regulated under the School Education Act, the National University Corporation Act and the Private Schools Act. An operator of a private school is required to obtain prior government approval.

**What is the applicable procurement process?**

The Public Accounting Act and the Local Autonomy Act set out the procedure for public procurement in Japan.

**Investing in energy and infrastructure**

There are three types of procurement process:

- an open bid where all contractors may bid;
• a selective bid where contractors designated by the central government or local public authorities may bid; and
• a single tender where a specific contractor may secure the public contract under special circumstances, such as urgent circumstances or where the relevant service or product considered can only be provided by a single supplier.

Where the government tenders a design and construction contract for a public project to private companies, a construction company may sometimes participate in the bid as a part of a consortium. A common form of a consortium involves a construction company as bidder, who subcontracts the building design or other consultation work to a construction consultant. As part of the bidding process, it is necessary for bidders who form a consortium to submit relevant information about subcontractors (such as past records of such subcontractor and a quotations) to the government in the course of the bidding process.

The general procedure for an open bid consists of the following:
• notification of tender opportunities;
• pre-bid meeting;
• commence bidding; and
• determine winning bid.

The general procedure for a selective bid consists of the following:
• qualification examination for the selective bid;
• notice of designation;
• commence bidding;
• determine winning bid; and
• conclusion of a contract.

The general procedure for a single tender consists of the following:
• selection of a counterparty, and
• conclusion of a contract.

Financing energy and infrastructure

When inviting bidders, public organizations may require the bidders to describe their funding arrangement or financial plan for the tendered public project. Specifically, bidders are required to provided information, such as their expected composition ratio of equity and debt and a redemption schedule of for such debt and equity.

Public organizations occasionally obtain funds directly from financial institutions by a procurement process.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Japan are as follows.

Funding

Common forms of funding in energy and infrastructure include:
• senior debt – loans made on a corporate finance basis, loans made on a project finance basis to a special purpose company and bond finance; and
• mezzanine debt – mezzanine loans and mezzanine bond finance.

Each method of funding can be greenfield funding (funding at the outset of a project) or brownfield funding (refinancing or additional
funding through the course of a project).

**Investing**

Common forms of investing in energy and infrastructure include:

- equity investments in ordinary shares;
- equity investment in preferred or subordinated shares; and
- other equity investments such as acquiring partnership interests.

Investments above are often made into a special purpose vehicle which subcontracts with other civil companies to build or operate the relevant infrastructure.

Each method of investment can be made by way of green field investment or brown field investment.

A listed infrastructure fund market which is similar to a listed real estate investment trust market was established in the Tokyo Stock Exchange in April 2015. Most listed infrastructure funds take the form of an investment corporation (toshi hojin).

**Restructuring**

**Enforcement and sanctions**

*When can there be regulatory investigations?*

The Securities and Exchange Surveillance Commission (SESC) may investigate breaches of relevant law and regulations, market misconduct and criminal violations. Following an investigation by the SESC, administrative disciplinary actions may be recommended to the Financial Service Agency or criminal charges may be filed by public prosecutors.

*What regulatory penalties may apply?*

Regulatory penalties include any of the following:

- a public announcement of misconduct;
- revocation of the relevant license;
- business suspension; and/or
- administrative fines.

*What criminal penalties may apply?*

Criminal penalties may be imposed in cases involving:

- false statements;
- insider trading;
- rumour spreading;
- fraud; and
Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

Stamp duty may be imposed depending on the type of instrument, if the instrument is executed within Japan. Registration tax is payable for registration of a real estate mortgage, a chattel mortgage or an assignment of a loan repayment right.

ADVANCE OF LOAN

Loan agreements are subject to stamp duty. The amount of stamp duty assessed varies depending on the loan amount. For example, JPY 100,000 would be assessed on a loan agreement with a loan amount of between JPY 100 million and JPY 500 million.

No registration, transfer or other similar taxes are payable on an advance of a loan.

TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN

Stamp duty is payable on an instrument evidencing an assignment of a loan repayment right. The assessed amount is JPY 200 per instrument.

Registration and transfer taxes are not, in principle, chargeable on the transfer or assignment of a loan. However, when utilizing the registration of an assignment of a loan repayment right in order to perfect the loan rather than informing a debtor of the transfer, which is the ordinary and tax-exempt method of perfection, a registration tax of JPY 7,500 would be imposed on each filing.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

TAKING OF A MORTGAGE OR SECURITY INTEREST

A mortgage instrument is not subject to stamp duty.

Registration tax is payable upon registration of a real estate mortgage, a chattel mortgage or an assignment of a security interest. The assessed amount is 0.4% of the loan amount for real estate mortgages however, a tax reduction measure can apply in certain cases such as where the mortgage concerns a factory. The assessed amount of registration tax for the filing of a chattel mortgage or assignment of a security interest is JPY 7,500.

TRANSFER OR ASSIGNMENT OF A MORTGAGE OR SECURITY INTEREST

Stamp duty is generally not chargeable on an instrument evidencing the transfer or assignment of a mortgage. If the instrument includes an assignment of a loan repayment right, an assessment of JPY 200 would apply.

The transfer of a real estate mortgage is assessed with a registration tax at a rate of 0.2% of the loan amount. When the transfer is caused by inheritance or as the result of a merger, a reduced taxation rate of 0.1% is applicable.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

ISSUE OF DEBT SECURITY
Bond instruments are subject to stamp duty when issued by a company in hardcopy (paperless bonds are not subject to stamp duty). The assessed amount differs based on the stated amount of the bond. For example, JPY 200 is assessed per bond instrument with a stated amount of JPY 5 million or less.

No registration, transfer or other similar taxes are payable on the issue of bonds.

TRANSFER OR ASSIGNMENT OF DEBT SECURITY

No stamp duty, registration, transfer or other similar taxes are assessed on the transfer or assignment of bonds.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Secured lenders and secured bond holders take priority over national and local taxation authorities regarding the enforcement of security, provided that the relevant debts are secured before the mandated deadline for tax payment. Also, once a loan or bond is secured, the priority position of the lenders and bond holders are maintained even if the collateral subject to the mortgage is transferred to a taxpayer with a tax liability to national or local tax authorities.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

There is no withholding tax when persons resident in Japan (including a domestic corporation) receive interest payments under a loan. Interest paid to persons not resident in Japan (including foreign corporations) is generally subject to withholding tax.

If so:

What is the rate of withholding?

The applicable withholding tax rate on interest paid to persons not resident in Japan (including foreign corporations) is 20.42%.

What are the key exemptions?

Double taxation treaties entered into by Japan may provide exemption, in whole or in part, from withholding tax on interest payments.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

For a bond, the withholding tax rate on interest paid to persons not resident in Japan (including foreign corporations) is 15.315%. The double tax treaties that may apply to interest payments under a loan may also apply to interest payments under bonds.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

No.
Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

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Key contacts

Kaoru Umino
Partner
DLA Piper Tokyo Partnership Gaikokuho
Kyodojigyo Horitsu Jimusho
kaoru.umino@dlapiper.com
T: +81 3 4550 2813
Luxembourg

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Luxembourg and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Luxembourg or to request that they are admitted to trading on a regulated market operating in Luxembourg unless an approved prospectus has been made available to the public.

Certain forms of companies cannot offer securities.

The International Capital Market Association has published standard form selling restrictions for offers of debt securities in Luxembourg. These restrictions are aimed at preventing a breach of:

- the rules on financial promotion; and
- the rules on accepting deposits in Luxembourg.

Worth noting the creation of the Luxembourg Capital Markets Association in 1ST March 2019.

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What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Luxembourg are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in Luxembourg. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities or perpetual debt securities;
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer, such as the so-called CPECs);
• depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
• warrants (securities giving the holders the option to purchase the equity of the issuer or a related company)

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What are the differences between offering debt securities to institutional / professional or other investors?

The Regulation (EU) 2017/1129 of the European Parliament of 14 June 2017 on the prospectus to be established when securities are offered to the public or admitted to trading on a regulated market, and repealing the Prospectus Directive ("Prospectus Regulation") makes a distinction between professionals (qualified investors) and other investors for the purpose of its disclosure requirements. The obligation to publish a prospectus does not apply to the offers of securities to the public addressed solely to qualified investors. Moreover, this obligation does not apply neither to offers of securities whose denomination per unit amount to at least €100,000.

According to the provisions of the Luxembourg law dated 16 July 2019 on prospectuses for securities ("Prospectus Law"), the obligation to publish a prospectus does not apply to some types of investors, such as qualified investors, which are defined as:

• professional clients listed under Sections 1 to 4 of Annex II of Directive 2014/65/EU on markets in financial instruments ("MIFID II"), such as credit institutions and investment firms; and
• persons or entities that are, on request, treated as professional clients in accordance with Section II of that Annex II of MIFID II, or recognized as eligible counterparties in accordance with article 2430 of MIFID II, unless they have requested to be treated as non-professional clients.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the 'wholesale' rules apply. If the denomination is under €100,000, the 'retail' rules apply. Additional disclosure requirements apply for retail securities.

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When is it necessary to prepare a prospectus?

Under the Luxembourg law dated 16 July 2019 on prospectuses for securities, any communication to any person(s), in any form and by any means that contains sufficient information on the terms of the offer and the securities being offered requires a prospectus so as to enable a potential investor to make their decision whether to purchase or subscribe for such securities.

An exemption from publishing a prospectus will apply, inter alia, to an offer:

• addressed solely to qualified investors (as explained below);
• addressed to fewer than 150 individuals or legal entities per EU or European Economic Area member state other than qualified investors, or where the offer is for a total of at least €100,000;
• addressed to investors who acquire securities for a total consideration of at least €100,000 per investor and for each separate offer; or
• involving securities with a total consideration of less than €8 million (such limit shall be calculated over a period of 12 months).

If the offer is deemed not to be made to the public, a prospectus which complies with the Rules and Regulations of the Luxembourg Stock Exchange may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having published a prospectus.

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What are the main exchanges available?

In Luxembourg, the Luxembourg Stock Exchange operates two different markets for trading debt securities:

• the regulated market qualifies as a European-regulated market as defined in the Directive 2014/65/EU on markets in financial instruments. This market offers a European passport that facilitates listing on other EU-regulated markets through a notification
procedure.

- the Euro MTF is a multilateral trading facility. Offering documents are subject to less stringent disclosure and reporting requirements but issued debt securities do not benefit from the European passport.

The Luxembourg Stock Exchange also offers the possibility to list securities on the securities official list (SOL), without any trading.

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Is there a private placement market?

Luxembourg has an active private placement market.

There is no dominant standard for documentation but efforts have been made by the Loan Market Association and International Capital Markets Association to standardize private placement documentation.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Luxembourg law. Luxembourg has various bondholder protection statutory provisions relevant to liability for an inaccurate offering memorandum. In this respect, article 12 of the Luxembourg law dated 16 July 2019 on prospectuses for securities provides that an administrative fine of a maximum amount of €700,000 may be imposed on an issuer providing incomplete or inaccurate information in a prospectus or if it publishes or causes to be published false information in a prospectus or a supplement to the prospectus. There are general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation. Criminal penalties (article 13 of the Prospectus Law) and publication of decisions (article 14 of the of the Luxembourg law dated 16 July 2019 on prospectuses for securities) are also possible.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their amendment without the consent of all bondholders, which may be exercised without the consent of bondholders and without regard to the interests of particular bondholders. The conditions also provide for meetings of bondholders to consider matters affecting the bondholders' interests. These provisions typically permit defined majorities to bind all bondholders including bondholders who did not attend and vote at the relevant meeting and bondholders who voted against the majority. Luxembourg law provisions applicable to bondholders' meetings can be excluded. Selling restrictions should also be considered.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing a fund, offering a fund and operating a fund, among other things, are regulated activities and are therefore subject to supervision of the Commission de Surveillance du Secteur Financier. Reserved alternative investment funds (RAIF) as well as partnerships (qualifying as alternative investment funds) are exempt from being subject to the supervision of the Commission de Surveillance du Secteur Financier. However, these investment funds will have to appoint an alternative investment fund manager who is in turn subject to the supervision of the Commission de Surveillance du Secteur Financier.
Collective investment schemes

The Commission de Surveillance du Secteur Financier has set out the following specific restrictions in relation to hedge funds in its Circular 02/80:

- risk diversification rules regarding short sales;
- borrowings;
- restrictions applicable to investments in target Undertakings for Collective Investment; and
- use of derivative financial instruments and other techniques.

There are no other specific restrictions in relation to hedge or debt funds other than those mentioned in the relevant laws.

What are common fund structures?

Common forms of funds include:

- Specialized Investment Funds which may qualify as Alternative Investment Funds (AIF);
- Undertakings for Collective Investments in Transferable Securities;
- Undertakings for Collective Investments pursuant to part II of the Luxembourg law of 17 December 2010 which may qualify as AIF;
- Reserved Alternative Investment Funds;
- companies investing in risk capital (these companies are not considered to be investment funds as they are not subject to diversification rules); and
- partnerships which may qualify as AIF.

What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Retail funds, which are mainly Undertakings for Collective Investments in Transferable Securities, are subject to substantial regulatory oversight and restrictions.

Institutional/professional funds

Non-retail funds are Specialized Investment Funds or Reserved Alternative Investment Funds which generally fall into the category of Alternative Investment Funds and will therefore have to appoint an Alternative Investment Fund Manager. As such, certain obligations with respect to marketing arrangements, reporting, governance etc are applicable.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Managing investment funds is a regulated activity and therefore subject to authorization and supervision of the Commission de
Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Undertakings for Collective Investments in Transferable Securities (UCITS)

Luxembourg Undertakings for Collective Investments in Transferable Securities (UCITs) may be offered for sale in Luxembourg without any restriction (private or public offer, institutional clients or not and whatever their number) as soon as they are registered on the official list of UCITs of the Commission de Surveillance du Secteur Financier.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Manager Directive, marketing is defined as a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM can only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).

Are there any restrictions on managing a fund?

An investment fund will either have to be managed by itself (not very common), by a management company or an Alternative Investment Fund Manager (AIFM) depending on the qualification of the investment fund itself.

The management functions of a management company are defined by the Luxembourg law which cannot be contravened, except if the management company holds the relevant license:

- portfolio management;
- administration, such as:
  - legal and fund management accounting services
  - customer inquiries
  - valuation of the portfolio and pricing of the units (including tax returns)
  - regulatory compliance monitoring
  - maintenance of unitholder register
  - distribution of income
  - unit issue and repurchase
  - contract settlements (including certificate dispatch)
  - record-keeping; and
- marketing.
Investment management functions which an AIFM must at least perform when managing an Alternative Investment Fund (AIF) are:

- portfolio management; and
- risk management.

The additional functions that an AIFM may perform in the course of the collective management of an AIF are restricted to the following:

- administration, such as:
  - legal and fund management accounting services;
  - customer inquiries;
  - valuation and pricing, including tax returns;
  - regulatory compliance monitoring;
  - maintenance of unit-/shareholder register;
  - distribution of income;
  - unit/shares issues and redemptions;
  - contract settlements, including certificate dispatch; and
  - record-keeping;
- marketing; and
- activities related to the assets of AIFs, namely services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters, advice and services relating to mergers and the purchase of undertakings and other services connected to the management of the AIF and the companies and other assets in which it has invested.

In order to apply for a license to act as a management company, self-managed company or AIFM, the relevant entity will have to submit various documents to the Commission de Surveillance du Secteur Financier in order to verify that the relevant company has sufficient technical and human infrastructure, expertise and policies in place.

However, AIFMs based in Luxembourg may be exempt from a full AIFM license and will only have to be registered with the Commission de Surveillance du Secteur Financier, in case either of the following is applicable:

- The AIFM is established in Luxembourg and which either directly or indirectly, through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manages portfolios of AIFs whose assets under management, including any assets acquired through use of leverage, in total do not exceed a total threshold of €100 million.
- The AIFM is established in Luxembourg and which either directly or indirectly, through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manages portfolios of AIFs whose assets under management in total do not exceed a threshold of €500 million when the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF.

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**Entering into derivatives contracts**

*Are there any restrictions on entering into derivatives contracts?*

Under Luxembourg law, there is no specific restriction for entering into derivative contracts such as:

- options;
- futures;
contracts for difference; or

rights to or interests in investments.

However, the European Market Infrastructure Regulation, as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

In addition, the provisions of the Luxembourg law dated 15 March 2016 on over-the-counter derivatives, central counterparties and trade repositories, as amended, grant powers to the Luxembourg supervisory authority of the financial sector (Commission de Surveillance du Secteur Financier) and the supervisory authority for insurance companies (Commissariat aux Assurances) in the context of Regulation 648/2012/EU (the European Market Infrastructure Regulation) as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 and specifies that the Commission de Surveillance du Secteur Financier and the Commissariat aux Assurances are vested with powers of supervision, intervention, inspection and investigation to the extent defined in the European Market Infrastructure Regulation as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 and that they may impose certain sanctions.

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What are common types of derivatives?

Derivative contracts are entered into in Luxembourg for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in Luxembourg:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Luxembourg are:

- equity;
- fixed income instruments; and
- foreign currency.

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Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought, in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulations and this has led to substantial compliance costs for market participants.

Last modified 10 Dec 2019
Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is a regulated activity in Luxembourg except, generally, in the following instances:

- one-off and ancillary lending activities;
- intra-group loans; or
- loans granted to a 'restricted circle of previously known persons' (cercle restreint de personnes préalablement connues), which are not considered as granted to the 'public', which is generally defined as a multitude of non-identifiable persons.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to other loans. For example, for regulated consumer loan contracts:

- the consumer must have at his disposal the information which will enable him to make his decision with full knowledge of the facts;
- before concluding the credit agreement, the credit institutions must assess the consumer's creditworthiness on the basis of a sufficient number of items of information; or
- the consumer is allowed to withdraw from the credit agreement without stating any reason within the period of 14 calendar days after the execution of the credit agreement.

Finally, a public limited liability company or a partnership limited by shares cannot advance monies, grant a loan, guarantee or security for the purchase of its own shares, subject to completing a whitewash procedure.

Borrowing

While borrowers are generally not regulated, borrowers should consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

For legal entities, borrowing should be permitted under its corporate object.

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What are common lending structures?

Loans can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility). Luxembourg law governed loans can be syndicated but are rare.

Syndicated facilities by their nature involve more parties (such as agents and security agents which fulfil certain roles for the finance parties) are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, asset backed loans, working capital loans, equity bridge facilities, project facilities or letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which
may be redrawn if repaid;

- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

**Loan commitment**

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

**Loan repayment**

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

**Repurchase agreements**

Repurchase agreements are also used as a financing tool.

*Last modified 10 Dec 2019*

**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight.

By contrast, lending in the context of mortgages and to consumers are subject to specific obligations on the lenders set out in the Luxembourg Consumer Code (ie more pre-information of the borrower).

As a more general principle, the Luxembourg courts determination as to whether lender misconduct is serious will be dependent on whether borrower is a professional or not.

*Last modified 10 Dec 2019*

**Do the laws recognize the principles of agency and trusts?**

**Agency**

Agency (mandat) is recognized by the Luxembourg Civil Code as a contract under which a principal grants to an agent power to act in its name and behalf. However, powers of attorney, mandates (mandats) or appointments of agents (including appointments made for security purposes) may terminate by law and without notice upon the occurrence of insolvency proceedings and may be revoked despite being expressed to be irrevocable.

The Law of 5 August 2005, on financial collateral agreements, as amended from time to time (the Collateral Law), provides that financial collaterals may be held by a person designated by the beneficiaries (ie security agents acting for the lender(s)) without owning any secured debt (so no parallel debt mechanism is needed). Security trustee arrangements are also recognized under the Collateral Law.

**Trust**
The concept of a trust is unknown under Luxembourg law. However, foreign law trust arrangements are recognized in accordance with the Hague convention of 1 July 1985 on the law applicable to trusts and on their recognition (Hague Trusts Convention), ratified by a Luxembourg law dated 27 July 2003 on trusts and fiduciary contracts, as amended from time to time.

Luxembourg law has implemented the concept of fiduciary (fiducie), which, however, does not offer the same features of a trust.

**Are there any other notable risks or issues around lending?**

**Generally**

Luxembourg loan agreements and finance documents are subject to general contractual principles. For instance:

- They should be entered into in *bona fide*.
- Penalty clauses (*clauses pénales*), and similar clauses on damages or liquidated damages are allowed to the extent that they provide for a reasonable level of damages.
- Compounding of interests is subject to certain conditions.
- Specific performance may not always be available and may result only in damages.

**Specific types of lending**

Specific to the area of mortgage lending is the issue of whether a lender falls within the recently formed Luxembourg mortgage loan regime. The Mortgage Credit Directive, implemented in Luxembourg in the Luxembourg Civil Code, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Mortgage Credit Directive applies to first and second ranking mortgages. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

**Standard form documentation**

Apart from consumer, mortgage or small corporate loans, major loan financings are not typically governed by Luxembourg law. However this may change as credit providers are using more regularly Luxembourg law.

Syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA). Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

**Are there any other notable risks or issues around borrowing?**

Borrowers should be aware of the potential implications of the EU’s Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions, implemented in Luxembourg by the Law of 18 December 2015 on the resolution, reorganization and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to ‘bail in’ obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. ‘Bail in’ describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Luxembourg or other EEA law
contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract, corporate interest and financial assistance matters are to be considered.

**Giving and taking guarantees and security**

*Are there any restrictions on giving and taking guarantees and security?*

Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to verify the constitutional documents of an entity giving a guarantee or granting security to ensure it has an express (or ancillary) power to do so and that giving a guarantee or granting security is not a (shareholder) reserved matter. If the provision of a guarantee or security exceeds the corporate object of the entity, it will still be bound to third-parties (*ultra vires*), unless there is evidence that the beneficiary of such act knew that the acts exceeded the corporate object of the entity or could not, in the light of the circumstances, have been unaware of that fact.

**Corporate interest**

The entry into the guarantee or security must be in the interest of the entity, which is a subjective and factual concept. The corporate interest must be assessed on a case-by-case basis by the board of the entity. The granting of a guarantee or security interest for the obligations of its parent (upstream) or its sister companies or affiliates (cross stream) is often more difficult. The concept of ‘group of company’ is not recognized as such and the interest of the group is not sufficient to justify the granting of upstream or cross-stream guarantees/security interests. Therefore, the Luxembourg entity giving the cross stream or upstream guarantee/security interest should:

- have some personal interest in granting such assistance (notably through the expected benefits) and act independently from third party considerations;
- take a commensurate risk in regard of the benefit deriving from the operation; and
- not face a financial exposure exceeding its financial means.

It is standard to include a guarantee limitation to address this issue, except for security interests which are deemed to be limited *per se*.

**Financial assistance**

It is unlawful for certain companies to provide financial assistance for the acquisition of its own shares by a third party. A whitewash procedure is envisaged by the Luxembourg law on commercial companies dated 15 August 1915, as amended from time to time, but it is rarely applied in practice.

**Insolvency**

Contractual commitments and guarantees are affected by the opening of insolvency proceedings. In case of such opening of insolvency proceedings secured/guaranteed creditors are registered as members of the general body of creditors. The Law of 5 August 2005, on financial collateral agreements, as amended from time to time, institutes however a framework whereby:

- Luxembourg or foreign bankruptcy and pre-bankruptcy rules are excluded in respect of financial collateral arrangements.
- Immunity from annulment risks in bankruptcy proceedings applies to collateral arrangements governed by the Law of 5 August 2005, on financial collateral agreements, as amended from time to time and to similar collateral arrangements governed by foreign law (provided that the collateral provider is established or resident in Luxembourg).
- There is primacy of financial collateral arrangements over (certain) foreclosure measures.
What are common types of guarantees and security?

Common forms of guarantees

FIRST DEMAND GUARANTEE (GARANTIE À PREMIÈRE DEMANDE)
This creates an abstract, autonomous and independent contractual recourse by the beneficiary against the guarantor. The guarantor may not rely on any exception, or exemption, derived from the underlying debt arrangement.

SURETYSHIP (CAUTIONNEMENT)
The suretyship is an accessory to the main monetary obligation. The guarantor may rely on exceptions, or exemptions, derived from the underlying debt arrangement.

It is worth noting that Luxembourg law only envisages payment guarantees (and not performance guarantees).

Other contractual arrangements can also be assimilated to a personal guarantee (e.g. "promesse de porte-fort", personal commitment letters).

Common forms of security

The most common types of security agreements are:

- pledge agreements over financial instruments and claims (including among others, intragroup or trade receivables and investors commitments);
- assignment for security purposes of financial instruments and claims;
- commercial pledges over assets (other than financial instruments);
- mortgages; or
- repurchase agreements.

It is worth noting that security must be granted on an asset by asset basis, except that pledges over ongoing business concerns are permitted but rarely used in practice.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

A civil guarantee must be created by an agreement in writing pursuant to the provisions of the Luxembourg Civil Code. Such a guarantee shall contain some handwritten information (e.g. the amount of the undertaking in letters and figures). Said restrictions do not apply to commercial guarantees.

Giving or taking security and mortgages

Mortgages must be executed as a notarial deed, involving notarial fees, stamp duties and the attendance by each party to the execution of the notarial deed (powers of attorney are permitted).

Once granted, security and mortgages need to be properly perfected before it can be invoked against third parties. Perfection formalities can range from the entry into the agreement, having the pledge registered in the register of shares/shareholders of the company, notices given to third parties or registration in public registers (depending on the asset).

Notarization is not required for pledge agreements under Luxembourg law.
The entry into the guarantee or security must be in the interest of the entity, which is a subjective concept. The corporate interest must be assessed on a case-by-case basis by the board of the entity. The granting of a guarantee or security interest for the obligations of its parent (upstream guarantee) or its sister companies or affiliates (cross stream) may rise some issues. The concept of group of company is not recognized as such and the interest of the group is not sufficient to justify the granting of upstream or cross stream guarantees or security interests.

Therefore, the Luxembourg entity giving the cross stream or upstream guarantee or security interest should:

- have some personal interest in granting such assistance (notably through the expected benefits) and act independently from third party considerations;
- take a commensurate risk in regard of the benefit deriving from the operation; and
- not face a financial exposure exceeding its financial means.

It is standard to include a guarantee limitation to address such an issue, except for security interests which are deemed to be limited per se.

Pledge agreements and, more generally, security interests governed by the Law of 5 August 2005, on financial collateral agreements, as amended from time to time (such as pledges over financial instruments and claims) are bankruptcy remote:

- they are valid even if entered into during the hardening period; and
- they can be enforced even after the opening of a bankruptcy proceeding.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Law of 5 April 1993 on the financial sector, as amended from time to time

Consumer credit

The Luxembourg Consumer Code


Mortgages

Articles 2114 to 2203 of the Luxembourg Civil Code

Mortgage loans are governed by the Luxembourg Consumer Code (please refer to the legislation in the 'Consumer credit' section above)

Companies

Articles 1832 to 1873 of the Luxembourg Civil Code

Law of 10 August 1915 on commercial companies, as amended from time to time
Funds and platforms

Law of 10 August 1915 on commercial companies, as amended from time to time

Law of 13 February 2007 on specialized investment funds

Law of 17 December 2010 on undertakings for collective investment

Law of 12 July 2013 on alternative investment fund managers

Law of 23 July 2016 on reserved alternative investment funds

Law of 15 June 2004 relating to companies investing in risk capital

Grand-ducal regulation of 8 February 2008 regarding Undertakings for Collective Investment in Transferable Securities (UCITS)

CSSF Regulation No. 10-04 regarding organizational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company of UCITS

CSSF Regulation No. 10-05 regarding mergers, master-feeder structures and notification procedures

CSSF Circular 07/283 regarding specialized investment funds

CSSF Circular 08/380 regarding eligible assets for investments by UCITS

CSSF Circular 11/498 regarding undertakings for collective investment

CSSF Circular 18/698 regarding authorisation and organisation of investment fund managers incorporated under Luxembourg law – special provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent

Other key market legislation

Law of 5 August 2005, on financial collateral agreements, as amended from time to time

Law of 18 December 2015 on the resolution, reorganization and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)


Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)

Law of 23 December 2016 on market abuse


Law of 30 May 2018 on markets in financial instruments

LuxSE Rules and Regulations

Law of 8 April 2019 on the measures to be taken in relation to the financial sector in the event of the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union

The law of 22 March 2004 on securitisation
Regulatory authorization

Who are the regulators?

The Luxembourg Supervision Commission of the Financial Sector (Commission de Surveillance du Secteur Financier) is the regulator which supervises the professionals and products of the Luxembourg financial sector.

It supervises, regulates through regulations and circulars, authorizes, informs, and, where appropriate, carries out on-site inspections (investigation power) and issues sanctions. Moreover, it is in charge of promoting transparency, safety, soundness and fairness in the markets of financial products and services and is responsible for the enforcement of laws on financial consumer protection and on the fight against money laundering and terrorist financing.

The Commission de Surveillance du Secteur Financier has 5 main missions: (i) prudential supervision of certain entities, (ii) public oversight of the audit profession, (iii) compliance with professional obligations, (iv) power of sanction and (v) national, European and international cooperation.

What are the authorization requirements and process?

Depending on the type of vehicle, it must apply to the Commission de Surveillance du Secteur Financier for authorization.

The following vehicles must apply for an authorization:

- Banks,
- Payment institutions and electronic money institutions,
- Professionals of the financial sector ("PFS") being either investment firms, specialised PFS or support PFS,
- Investment vehicles and managers governed by the laws, regulations and circulars referred to in the "Law and regulation" section.

The regulator must assess whether the vehicle meets the requirements set out under Luxembourg law to approve the relevant application. According to the Law of 5 April 1993 on the financial sector, as amended from time to time, the Commission de Surveillance du Secteur Financier has to respond to an application within six months of receipt of the application or, if the application is incomplete, within six months of receipt of the informed needed. Absent this decision during this time frame, it is deemed equivalent to a notification of refusal. However, the Commission de Surveillance du Secteur Financier is usually responsive.

As mentioned above, credit institutions and must be authorized to exercise their financial activities.

Credit institutions

Banks located in Luxembourg must hold a bank license granted by the Minister of Finance.

Credit institutions from the European Economic Area ("EEA") benefit from the passport for banking services and the freedom to provide banking services in Luxembourg.

Non-EEA credit institutions coming occasionally and temporarily to Luxembourg to provide services must hold an authorization granted by the Minister of Finance.

Application forms dealing with the following criteria shall be completed and sent to the Commission de Surveillance du Secteur Financier and shall include, inter alia, legal form, capital base, central administration and infrastructure, managing body, shareholders, professional standing, knowledge, competences and experience, governance and remuneration policy, external auditing and deposit guarantee and investor compensation.
Professionnels du secteur financier (PFS)

PFS include investment firms referred to in Part I, Chapter 2, Section 2, Subsection 1 of the Law of 5 April 1993 on the financial sector, as amended from time to time (1993 Law).

Specialized PFS are referred to either in Part I, Chapter 2, Section 2, Subsection 2 or in Article 13 of the 1993 Law and which do not belong to the categories of the first and third indent of such definition.

Support PFS are referred to in Part I, Chapter 2, Section 2, Subsection of the 1993 Law.

Application forms dealing with the following criteria should be completed and sent to the Commission de Surveillance du Secteur Financier and should include, inter alia:

- legal form;
- capital base;
- central administration and infrastructure;
- shareholders;
- professional standing and experience;
- external audit; and
- participation in an authorized investor compensation scheme (only for investment firms).

Procedure

Authorizations are subject to prior examination by the Commission de Surveillance du Secteur Financier and final granting by the Minister of Finance.

Fees to be paid to the Commission de Surveillance du Secteur Financier depends on the entity, its form and business. The Commission de Surveillance du Secteur Financier charges an annual fee as well as a fee for the examination.

Supervised entities are listed on the webpage of the Commission de Surveillance du Secteur Financier.

What are the main ongoing compliance requirements?

All entities under the supervision of the Commission de Surveillance du Secteur Financier must comply with all Luxembourg laws and regulations on an ongoing basis.

In respect of credit institutions, banks shall transmit to the Commission de Surveillance du Secteur Financier mainly financial and accounting data relating to their activities on a monthly, quarterly, half-yearly or annual basis, depending on the object.

The Commission de Surveillance du Secteur Financier must assess whether the application meets the threshold required by Luxembourg law and regulations.

For the instructions relating to the ongoing information to be provided by a PFS, please refer to circulars CSSF 05/187, CSSF 10/433 CSSF 08/364, IML 96/124.

What are the penalties for failure to be authorized?

A person or company undertaking a regulated activity without being authorized or exempt commits a criminal offence and is liable to imprisonment and fines. Administrative sanctions and nullity of the agreements is also possible.
Regulated activities

What finance and investment activities require authorization?

Generally

A person must not carry on a regulated activity in Luxembourg unless authorized or exempt (known as the general prohibition).

Any activity dealing with financial matters, advice or money constitutes a financial activity. The existence of a money flow is an important indication to establish whether an activity qualifies as a financial sector activity. However, the Commission de Surveillance du Secteur Financier shall decide for each specific activity whether authorization is required.

- Specified activities include accepting deposits, dealing in, managing, arranging and advising on investments, and establishing collective investment schemes.
- Specified investments include deposits, shares, debt instruments, options, futures, units in a collective investment scheme and government and public securities.

Consumer credit

Consumer credit activities, including credit brokering, operating an electronic system in relation to lending and entering into a regulated credit agreement as lender are deemed regulated activities.

The granting of consumer loans requires prior authorization unless covered by the exemptions set out in article L. 224-3 of the Luxembourg Consumer Code, including inter alia granting of loans for an amount below €200 and above €75,000 and loans granted to acquire or maintain ownership of real estate land, or an existing building or a building to be constructed.

Are there any possible exemptions?

Regulated activities may be undertaken without authorization if either a general or specific exclusion applies.

General exclusions

General exclusions include:

- one-off and ancillary regulated activities;
- intra-group activities;
- loans granted to a ‘restricted circle of previously known persons’ (cercle restreint de personnes préalablement connues), which are not deemed to be granted to the ‘public’, which is generally defined as a multitude of non-identifiable persons; or
- the exercise of a financial sector activity or a connected or ancillary activity, which is not carried out on a regular basis (legal assessment required).

Specific exclusions

A Luxembourg Reserved Alternative Investment Fund (RAIF) is exempt from being authorized by the Commission de Surveillance du Secteur Financier. However, a RAIF will have to appoint an alternative investment fund manager, who is in turn authorized and supervised by the Commission de Surveillance du Secteur Financier.

Loan origination and loan participation and/or acquisition are permissible activities for Luxembourg entities subject to due compliance by the manager and the Luxembourg entity, where applicable, with the requirements set forth in the Commission de Surveillance du Secteur Financier.
**Do any exchange controls or other restrictions on payments apply?**

Luxembourg does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in or out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

There may also be anti-money laundering and tax considerations to take into account.

**What are the rules around financial promotions?**

**Rules**

A financial promotion is a communication of an invitation or inducement to engage in a financial activity made by a person in the course of business. Since such communications can influence consumers, a person is restricted from communicating such promotions unless he/she is an authorized person, or the content of the communication has been approved by an authorized person, or the promotion falls within one of the exemptions.

An unauthorized person who communicates a financial promotion may be held liable for carrying out such activity without being licensed.

**Exemptions**

Promotions are allowed for those persons and entities authorized by the regulator or permitted (ie benefitting from an exemption) to do so.

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

Credit institutions may only be incorporated as a public-law institution, a société anonyme (public limited liability company), a société en commandite par actions (partnership limited by shares) or a société cooperative (cooperative).

Authorization for any activity involving the management of funds belonging to third parties may only be granted to legal persons having the form of a public entity or a commercial company.

The legal form that a professional of the financial sector (professionnel du secteur financier (PFS)) should adopt, as well as the capital base that it must have, depends on the activity that it intends to carry out. The choice of the legal form of the future PFS shall be made while taking into account the general and special legal conditions applicable to the authorization that is sought.

Investment funds may be set up as companies or partnerships.
Is it possible to conduct lending or investment business through a branch or establishment?

Yes, it is possible to conduct lending or investment activities through a branch in Luxembourg.

Branch means ‘a place of business other than the head office which is a part of a credit institution or an investment firm, which has no legal personality and which performs directly, entirely or in part transactions related to the activity of credit institutions or provides investment services and/or activities and which may also perform ancillary services for which the investment firm has been authorized.’

The exercise of these activities by a branch of a credit institution or investment firm authorized in another member state is not subject to authorization by the Luxembourg authorities provided that these activities fulfil the requirements laid down in article 30 of the Law of 5 April 1993 on the financial sector, as amended from time to time.

Credit institutions and investment firms governed by a non-member state and wishing to establish a branch in Luxembourg are subject to the same authorization rules as those applying to credit institutions and other professionals of the financial sector governed by Luxembourg law.

Foreign companies performing activities in Luxembourg, which lead to the creation of a permanent establishment, may be subject to tax on income attributable to such a permanent establishment.

FinTech

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure (which inter alia can be set up as a (regulated) securitization vehicle);
- applying technology to leverage and optimize the lending platform and user experience;
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship; and
- virtual payment applications (eg using smartphones).

Instead of having a central institution (such as a regulated credit establishment) granting loans, these are made by ‘peers’ (eg retail or institutional investors, or funds), subject however to certain restrictions as lending activities are regulated activities.

Alternative credit providers involved in FinTech applications are gaining market share, based on a specific framework. In this respect, loan origination and loan participation or acquisition (as these terms are defined in the CSSF Frequently Asked Questions, version 11, dated 6 July 2017 cannot exclude the possibility that a Luxembourg court will find otherwise based on the law dated 5 April 1993 on the financial sector as amended from time-to-time.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
• small and medium-sized enterprises (SME) lending; and
• residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P) type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, the funding structure will often follow the format of a warehouse securitization structure or fund. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt this will typically result in the platform being treated as a securitization for the purposes of the European Union Capital Requirements Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record, for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).
Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

**WHAT IS A CRYPTOCURRENCY?**

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

The Commission de Surveillance du Secteur Financier published a warning on virtual currencies on 14 March 2018 in order to state that virtual currencies are not currencies, are not regulated, not guaranteed by a central bank or a deposit guarantee scheme. Their high volatility bears a number of risks including total loss of investment.

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is expanding). ICOs come in wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.
Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

The Commission de Surveillance du Secteur Financier published a warning on initial coin offerings (ICOs) and tokens on 14 March 2018 in order to state that raising funds from the public in the form of so-called initial coin offerings is not subject to a specific regulation and does not benefit from any guarantee or other form of regulatory protection. ICOs are highly speculative investments that may lead to a total loss of investment.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

The Commission de Surveillance du Secteur Financier published the 27 March 2018 its position on Robo-advice as well as, in December 2018, a White Paper on Artificial Intelligence: Opportunities, risks and recommendations for the financial sector. This White Paper aims at better understand what Artificial Intelligence is and the related risk as well as explain some practical use cases for the financial sector. An analysis of the main risks associated and key recommendations to take into account when implementing Artificial intelligence inside a business process are also covered.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Last modified 10 Dec 2019

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

The Commission de Surveillance du Secteur Financier (CSSF) supervises the professionals and products of the Luxembourg financial sector. It supervises, regulates, authorizes, informs, and, where appropriate, carries out on-site inspections and issues sanctions.

The National Commission for Data Protection (Commission Nationale pour la Protection des Données or CNPD), is the Luxembourg
independent authority verifying the legality of the processing of personal data and ensuring the respect of personal freedoms and fundamental rights with regard to data protection and privacy. Its mission also extends to ensuring the respect of the Law of 30 May 2005 regarding the specific rules for the protection of privacy in the sector of electronic communications and the Luxembourg law of 1 August 2018 on the organisation of the National Data Protection Commission and the general data protection framework (short title).

GENERAL CSSF POSITIONS

The CSSF was one of the first European regulators to take position on FinTech. On 14 February 2014, the CSSF published a communique, with the following points in respect of virtual currencies:

- Virtual currencies are considered as scriptural money (as opposed to cash money in the form of bank notes and coins), since they are accepted as a means of payment for goods and services. The issuing of virtual money is not regulated from a monetary point of view, they are not legal tender and they entail risks.

- No one can be established in Luxembourg to carry out an activity in the financial sector without an authorization by the Minister of Finance and without being subject to the prudential supervision of the CSSF. The potentially interested persons who would like to establish themselves in Luxembourg in order to issue means of payments in the form of virtual currencies, provide payment services using virtual currencies or create a platform to trade virtual currencies, are required to define their business purpose and their activity in a sufficiently concrete and precise manner to allow the CSSF to determine which status they need to receive a ministerial authorization for.

The position of the CSSF in respect of virtual currencies has been confirmed by the European Court of Justice on 22 October 2015.

More generally, the CSSF has a balanced approach toward FinTech companies and applies the existing regulatory framework (ie the current European Union regulatory framework, as implemented in Luxembourg) in a proportionate way. The CSSF has to determine the potential benefits of the submitted innovation and whether there could be regulatory barriers linked to the innovative character of the business model it could address without circumventing the regulatory requirements. One of the main challenges is to identify risks (cyber-risks, fraud and anti-money laundering/combating the financing of terrorism risks), which have to be properly assessed together with the mitigating measures that can be applied.

The CSSF has established a division dedicated to financial innovation and technology, focused on developing, facilitating and securing FinTech businesses.

The blockchain has also been implemented in Luxembourg law with, inter alia, the law of 1rst March 2019 amending the Luxembourg law of 1rst August 2001 on the circulation of securities introducing a new article 18bis in the law of 1rst August 2001 by specifying that securities may be booked and transferred through secure electronic recording devices, in particular through distributed ledgers such as blockchain, providing an alternative to the dematerialisation processes already known.

Electronic payments platforms, payment services and regulation of peer-to-peer lenders

PAYMENT INSTITUTIONS

The services offered by Payment Institutions (PIs) can vary from the provision of payment infrastructures to customers (eg for services industries) to services enabling payments between individuals. It also includes facilitation of secure credit and debit card transactions, both nationally and internationally.

ELECTRONIC MONEY INSTITUTIONS

Pursuant to article 1 (29) of the Luxembourg law of 10 November 2009 on payment services, on the activity of electronic money institutions (EMIs) and settlement finality in payment and securities settlement systems, as amended (PSL), electronic money (Electronic Money) means a monetary value represented by a claim on the issuer, which is:

- electronically, including magnetically, stored;
- issued on receipt of funds for the purpose of making payment transactions; and
- accepted by a natural or legal person other than the Electronic Money issuer.

EMIs are institutions issuing Electronic Money.

In addition to issuing Electronic Money, EMIs are also permitted to supply all services of PIs, to grant loans (under certain conditions)
linked to payment services, to supply operational services and other services closely linked to the issuing of electronic money or to the
supply of payment services.

REGULATION OF PAYMENT SERVICES, PAYMENT INSTITUTIONS AND EMIS

PIs and EMIs in Luxembourg are governed by the PSL, deriving from the interpretation of Directive 2015/2366 on payment services in
the internal market (the second payment services Directive) ("PSD 2") repealing Directive 2007/64/EC of 13 November 2007 on payments
services in the internal market, and of Directive 2009/110/EC of 16 September 2009 on the taking up, pursuit and prudential supervision
of the business of EMIs.

Since 2007, many changes in the digitalization of financial services have led to the need for an update of the Directive 2007/64. The PSD 2
aims to tackle the shortcomings of the first directive in the modern era by impacting PIs and EMIs. PSD 2 introduced two new third-party
payment service providers: Payment Initiation Services Providers and Account Information Service Providers.

Before taking a formal decision to set up an EMI or PI in Luxembourg, the prospective institutions should be approved by the CSSF and
comply with mandatory conditions (e.g., legal form, capital requirements).

PEER-TO-PEER LENDERS

Under Luxembourg law, there is no specific regulatory framework in respect of peer-to-peer lending. As a result, European regulation,
which mainly consists of the following, applies:

• Regulation (EU) 2017/1129 of the European Parliament of 14 June 2017 on the prospectus to be established when securities are
  offered to the public or admitted to trading on a regulated market;

• Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers; and
  Directive 2007/64.

Note that the current position of the European Commission is that there is no need for a specific European regulation in respect of
marketplace lending activities. Priority will be given to updating the current regulatory framework regulating the marketplace lending
activities.

In addition, no one can be established in Luxembourg to carry out an activity of the financial sector without an authorization by the
Minister of Finance and without being subject to the prudential supervision of the CSSF. The potentially interested persons who would like
to establish themselves in Luxembourg to carry out marketplace lending activities are required to define their business purpose and their
activity in a sufficiently concrete and precise manner to allow the CSSF to determine for which status they need to receive a ministerial
authorization.

Under Luxembourg law (article 24-8 of the law of 5 April 1993 on the financial sector, as amended (1193 Law)), professionals carrying on
lending operations are professionals engaging in the business of granting loans to the public for their own account, are required to be
authorized to carry out these activities. The following, in particular, shall be regarded as lending operations for the purposes of this article:

• financial leasing operations involving the leasing of moveable or immovable property specifically purchased with a view to such
  leasing by the professional, who remains the owner thereof, where the contract reserves to the lessee the right to acquire, either
during the course of or at the end of the term of the lease, ownership of all or any part of the property leased in return for payment of
  a sum specified in the contract; and

• factoring operations, either with or without recourse, whereby the professional purchases commercial debts and proceeds to collect
  them for his own account.

This article shall not apply to persons engaging in the granting of consumer credit, including financial leasing operations as defined in
paragraph 2(a) of this article, where that activity is incidental to the pursuit of any activity covered by the law dated 2 September 2011
regulating the access to the profession of craftsman, merchant, industrial as well as certain liberal professions.

Article 24-8 of the 1993 Law shall not apply to persons engaging in securitization operations. Also, authorization to act as a professional
carrying on lending operations may be granted only to legal persons and shall be conditional on the production of evidence showing the
existence of a share capital of not less than €730,000.
Also, applicable regulation will depend on the form of the vehicle used for the purposes of carrying out the marketplace lending activities (eg securitization vehicle or investment fund).

**Application of data protection and consumer laws**

The European General Data Protection Regulation ("GDPR") regulates the processing of personal data in Luxembourg. Where a business determines the purposes and manner in which any personal data is processed or processes personal data upon instructions and on behalf of a third party, it will be regulated by the GDPR and have certain compliance obligations. For instance, depending on the situation, a business may have to carry out mandatory notifications where a personal data breach occurs, or where it wishes to put in place a system allowing the surveillance of its employees. In any case, businesses will have to abide by the "data protection by design and by default" principles, which include e.g. the provision of transparent information to individuals whose personal data is processed, and the maintenance of extensive internal compliance documentation.

The Luxembourg law of 1 August 2018 on the organisation of the National Data Protection Commission and the general data protection framework (short title). The Luxembourg law of 30 May 2005, laying down specific provisions for the protection of persons with regard to the processing of personal data in the electronic communications sector, regulates unsolicited direct marketing by electronic means.

**Cloud computing**

On 17 May 2017, the CSSF published the Circular 17/654, as amended by Circular 19/714 (Circular) on IT outsourcing based on a cloud computing infrastructure. The Circular is designed to clarify the regulatory framework for the use of a cloud computing infrastructure supplied by an external service provider. The Circular confirms that CSSF considers that cloud computing is a form of outsourcing. The Circular applies immediately to financial professionals, including credit institutions, investment firms, specialized financial sector professionals (FSPs), support specialized financial sector professionals, as well as PIs, and EMI.

According to the CSSF, cloud computing is a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (eg networks, servers, storage, applications and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction.

**Money laundering regulations**

The CSSF is in charge of supervising the anti-money laundering (AML) controls of supervised entities (eg FinTech companies) which have to comply with:

- the law of 12 November 2004 as amended (Title I, coordinated version);
- the Luxembourg law of 27 October 2010 enhancing the AML and counter-terrorist financing legal framework;
- the grand-ducal regulation of 29 October 2010; and
- the CSSF Regulation N°12-02 on the fight against money laundering and terrorist financing.

Generally, where a firm is authorized and supervised by the CSSF it will also be authorized and supervised by the CSSF for complying with AML requirements. Electronic currencies such as bitcoin and other cryptocurrencies tend to represent a higher money-laundering risk.

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**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of
the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital (VC) providers.

For instance, in Luxembourg, the Digital Tech Fund provides seed financing to entrepreneurs running innovative startup companies active in the field of digital technologies. The fund's aim is to foster long-term innovation, support the technology startup ecosystem in Luxembourg and facilitate the transfer of new digital technologies developed at the University of Luxembourg into successful spin-off companies.

CROWDFUNDING

The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

In Luxembourg, the Luxembourg House of Financial Technology (LHoFT) has been recently created. The LHoFT is a public-private joint venture that drives technology innovation for Luxembourg's financial services industry, connecting the domestic and international FinTech community.

Among other benefits, the LHoFT offers:

- startup incubation;
- co-working spaces; and
- a soft-landing platform.

The LHoFT connects and creates value for the entire Luxembourg FinTech ecosystem: financial institutions, FinTech trailblazers, the IT industry, research and academia as well as regulatory and public authorities.

Venture capital and debt

Venture Capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

European Venture Capital Funds (EuVECA) constitute alternative investment schemes that focus on startups and early stage companies such as FinTechs. EuVECA have been implemented by the Regulation no 345/2013 on European Venture Capital Funds (Regulation 345/2013). As part of its drive to improve the functioning of Europe's capital markets and to develop alternative sources of finance for small and medium-sized enterprises, including VC, in July 2016 the European Commission announced amendments to Regulation 345/2013 to encourage more fund managers to establish funds under this regime. A political agreement between the co-legislators was reached on 30 May 2017 and the revised regulation should be formally adopted soon.
Warehouse and platform funding

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms such as Lendix and CrossLend, which bring individual borrowers and lenders together without the involvement of traditional banks.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Luxembourg has both debt and equity capital markets which are accessible to businesses.

A FinTech that has grown to a certain size may finance itself by way of an Initial Public Offering (IPO). An IPO is the initial sale of company shares on a public exchange, such as the Luxembourg Stock Exchange.

Marketplace loan securitisations have been launched in Luxembourg, where loans originated via marketplace lending platforms are packaged together and sold to investors as bonds. For example, in 2015 CrossLend set up a securitization vehicle to carry out P2P lending. The CrossLend subsidiary issuing the bonds decided to be regulated in Luxembourg because of Luxembourg’s expertise in securitization, as well as the accessibility and responsiveness of the Commission de Surveillance du Secteur Financier (CSSF).

CONVERTIBLE BONDS/LOAN NOTES

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

Incentives and reliefs

A range of support initiatives make Luxembourg the ideal place to engage in a FinTech startup. FinTech startups can combine private funding with public funding schemes for research, development and innovation.

Also, FinTech companies can obtain funding from the €150 million Luxembourg Future Fund (which aims to stimulate the diversification and sustainable development of the Luxembourgish economy – ie companies active in the information and communications technology, cleantech and other technology sectors excluding health technologies and life science sectors), as well as the Digital Tech Fund. Meanwhile, incubator and accelerator facilities offer physical space designed to foster business development and provide invaluable networking opportunities.

Different platforms such as the Luxembourg House of Financial Technology (LHoFT) exist, bringing together financial institutions, FinTech innovations, research, academia and public authorities, to help drive forward the development of products which meet specific industry needs.

Tax incentives

NEW LUXEMBOURG INTELLECTUAL PROPERTY REGIME

Intellectual property (“IP”) rights relating to FinTech may benefit from the new IP regime introduced in Luxembourg law in March 2018.
The new article 50ter of the Luxembourg Income Tax Law provides for a partial exemption of 80% on the net income derived from eligible IP assets.

Under this law, patents and copyrights on computer software, among others, including those related to FinTech, are eligible assets for the preferential tax treatment. However, assets of marketing nature, such as trademarks, are outside of the scope.

Eligible income that will qualify for preferential tax treatment includes net income from direct use, royalties from the granting of licenses or income from the sale of eligible IP assets.

The proportion of net income qualifying for the preferential tax treatment will be determined based on the nexus ratio, which is the proportion of eligible expenditure to total expenditure. Total expenditure, under the law, basically includes research and development ("R&D") expenses directly related to the IP assets in question.

All costs not directly related to an eligible IP asset (e.g. real estate costs, interest, financing costs and acquisition costs of IP assets) are not eligible and fall outside the scope of the calculation of the tax exempt income.

The eligible expenditure can be uplifted by 30%. This uplift is allowed as long as the eligible expenditure does not exceed the total amount of expenditure.

The IP activity of the company should be properly documented to demonstrate the link between the eligible IP assets and the related expenses. The taxpayer must also be ready to share this information with the Luxembourg tax authorities, if need be.

DEDUCTIBILITY OF INTERESTS

Payments of interest made by a Luxembourg borrower to a lender through a P2P platform are, in principle, exempt from withholding tax.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Assignment of claims** – Subject to any contractual restrictions, assignment can be done without the consent of the debtor (although it has to be notified in accordance with article 1690 of the Luxembourg Civil Code).

- **Assignment of contract** – Assignment generally require the consent of the debtor (as this right be seen as a novation).

- **Novation** – Under novation contracts, the parties agree to terminate the existing debt and a new debt is created. Novation can only occur in three situations under Luxembourg law:
  - substitution of debt;
  - change of debtor; and
  - change of creditor.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association (LMA). For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the underlying assets being sold.
**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the legal advisors. Some of the key considerations include:

- **Confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **Data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **Lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **Undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **Transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its term;
- **Consent** – whether a transfer requires the consent or notification of any other parties; and
- **Preservation of security/perfection formalities** – whether the underlying security is preserved in favor of the new lender and whether any perfection formality is needed for the transfer to be enforceable.

*Last modified 10 Dec 2019*

**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

Various industries have been privatized or liberalized in Luxembourg further to the EU liberalization and free-market policy.

In Luxembourg, rail, roads, waste, health, justice/prisons, defense, social housing and education are mostly publicly owned.

Telecoms, space related activities, aviation, energy are mostly privatized, however, the most important companies operating in this field in Luxembourg are owned by the public sector (eg Post, Luxair, Enovos, SES).

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**Are there special rules for investing in energy and infrastructure?**

There are no overall domestic restrictions, except in relation to certain utilities. Obligations resulting from anti-money laundering legislation and regulations should also be taken into account.

Luxembourg has an open policy towards foreign investments, promoted by means of, *inter alia*, grants of subsides.

Luxembourg is part of the Belgo-Luxembourg Economic Union which mainly aims at supporting, stimulating and protecting investments. It has signed some 100 bilateral investment treaties with various states around the world which generally create a legal and regulatory framework preventing protectionism with respect to foreign investments.

No governmental approvals are required for project finance transactions. However, a business license may be required if the activity in Luxembourg goes beyond the pure financing of the project and involves carrying out commercial activities in Luxembourg. In such case, a business license must be sought from the *Direction Générale PME et Entrepreunariat*.

Public procurements are regulated.

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What is the applicable procurement process?

Contracts with public entities are subject to public bid restrictions imposed by EU law and national laws. These rules impose a public tender process, governed by the public procurement rules implemented by the Luxembourg law dated 8 April 2018 on public procurement, as amended from time to time.

The key principles are that contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

The procurement process is as follows:

Prerequisite

The submission criteria are detailed in the tender documents accompanying the public contract notice or are sent directly to the business (procedure without publication). The following information is provided:

- award criteria, the weighting given to each criterion and the rating system;
- the minimum criteria for participation in case of a public tender;
- deadlines;
- penalties for delays;
- possible bonus for termination of works before the deadline;
- technical description of variants; and
- insurance policies to take out.

Preliminary steps

When the business has identified a potentially interesting public procurement notice or if it has been invited by a contracting authority to tender a bid, it must verify that:

- the means (human, technical, financial etc) at its disposal meet the contract requirements; and
- it can meet the deadlines.

Types of procedures

There are several types of public procurement procedures, amongst others:

- open procedures, which require the procurement contracts to be publicly advertised;
- restricted procedure may be used in the cases mentioned in article 66 of the Luxembourg law dated 8 April 2018 on public procurement;
- exceptional procedures, which depend on the scope of the procurement contract (regarding procurement contract below or above certain thresholds);
- negotiated procedure or restricted procedure without publication;
- negotiated procedure (regarding, inter alia, rescue services, police, customs);
- negotiated procedure with or without prior publication (in instances mentioned in article 19 and 20 of the Luxembourg law dated 8 April 2018 on public procurement, as amended from time to time); and
- competitive dialogue (in instances mentioned in article 68 of the Luxembourg law dated 8 April 2018 on public procurement, as amended from time to time).

Preparing the tender
A business must meet all requirements detailed in the tender documents. This document defines the works or services to be carried out, the tendering conditions and the documents requested by the contracting authority.

Bid documents which do not meet the conditions laid down in the tender documents are rejected.

However, since the reason for a rejection will be provided, any business that believes it has been treated unfairly may lodge an appeal. The bid document allows the business to:

- present itself or the members of the group of businesses;
- highlight its experience;
- put forward its financial means and guarantees;
- put forward the advantages it has over the competition; and
- define its project.

The business may, within a reasonable time limit, request clarifications concerning the contract from the contracting authority. Answers are sent to all the participants.

**Tendering the bid**

To be eligible, a company must meet the deadlines for submission of the application/tender. The tender may be submitted personally in exchange for a receipt or sent by mail with acknowledgement of receipt.

**Administrative certificates**

Depending on the procedure, the business must also prove that it has fulfilled its professional obligations by attaching the following documents to its tender:

- a non-liability certificate from the Joint Social Security Centre (Centre Commun de la Sécurité Sociale);
- a certificate of compliance with respect to value added tax obligations and liability from the Land Registration and Estates Department (Administration de l’Enregistrement des Domaines et de la TVA);
- a non-liability certificate from the Luxembourg Inland Revenue (Administration des Contributions Directes – (ACD)), delivered on simple request at the competent tax office of the ACD; and
- an extract from the criminal records.

Where applicable, national and foreign subcontractors must also provide these certificates.

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**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

Sources of financing are mostly provided by leading foreign financial institutions and private investors but also by investment funds offering structured solutions for public projects established within a public-private partnership.

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bonds; and
- mezzanine debt.
Investing

Common forms of investing in energy and infrastructure include:

- equity investment in special purpose vehicles or entities that may have a portfolio of interests, such as share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of equity).

Restructuring

Enforcement and sanctions

**When can there be regulatory investigations?**

When the *Commission de Surveillance du Secteur Financier* considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

**What regulatory penalties may apply?**

When a rule breach has taken place, the *Commission de Surveillance du Secteur Financier* may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

**What criminal penalties may apply?**

Following formal investigation, the Luxembourg criminal courts have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the money laundering regulations; and
- conducting regulated activities when not authorized.

Tax

Tax issues

**Are stamp, registration, transfer or other similar taxes applicable?**

**Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?**

Luxembourg law does not require the lending of funds, transfer or assignment of a loan to be registered with tax authorities. Hence, no registration tax is payable on the lending of funds or the transfer or assignment of a loan.
Registration duties may be payable upon voluntary registration.

No stamp duty, transfer tax or other similar taxes are payable on the lending of funds, transfer or assignment of a loan.

**Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

Luxembourg law does not require the act of taking, transferring or assigning a debenture or other security to be registered. Hence, no registration tax is payable upon the taking, transferring or assigning of a debenture or other security.

The grant, transfer and assignment of a debenture or other security may, however, be registered on a voluntary basis.

The grant and renewal of mortgages, as well as their transfer and assignment, should be registered and should underly registration duties.

No stamp duty, transfer tax or other similar taxes are payable upon the grant, transfer or assignment of a mortgage, debenture or other security.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?**

Luxembourg Law does not require the issue, transfer or assignment of debt securities to be registered. Hence, no registration tax is payable upon the issue, transfer or assignment of debt securities.

The issue of debt securities, the transfer of debt securities and the assignment of debt securities may be registered on a voluntary basis.

No stamp duty, transfer tax or other similar taxes are payable upon the issue, transfer or assignment of debt securities.

**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

On the enforcement of security, the tax authorities have priority over secured lenders and secured debt security holders.

**Is withholding tax on interest payments applicable?**

Interest payments are not subject to withholding tax (WHT) in Luxembourg except in the following cases:

- Interest payments to a silent partner in proportion to the profit realized may be subject to a 15% WHT.
- Interest payments on profit sharing bonds may be subject to a 15% WHT.
- Interest payments can be requalified into dividends and are then subject to a 15% withholding tax where a Luxembourg company is over-indebted in light of thin capitalization rules or where a Luxembourg company does not comply with transfer pricing regulations.
- Interest payments made by Luxembourg resident paying agents to Luxembourg resident individuals are subject to a 20% WHT. There is an exemption from WHT if the amount due does not exceed €250.
- Where interest payments are made or credited by foreign paying agents located in a member state of the EU or in a state of the European Economic Area, the Luxembourg resident taxpayer may opt for a 20% WHT.
Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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Key contacts

Xavier Guzman
Partner
DLA Piper Luxembourg
xavier.guzman@dlapiper.com
T: +352 26 29 04 2052
Mauritius

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities in Mauritius. Save for certain exclusions or exemptions, it is unlawful to offer debt securities to the public or to request that they are admitted to trading on a regulated market unless a registered prospectus has been made available to the public.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Mauritius are bonds or notes issued. Many different types of debt securities are offered. Some common forms include:

- derivative securities such as securities linked to the value of one or more reference asset, including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- project bonds (green bonds, debt securities that are issued to finance the construction of a single asset, a portfolio of projects, or to refinance bank debt that will promote progress on environmentally sustainable activities); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

What are the differences between offering debt securities to institutional/professional or other investors?

Under the Securities Act 2005, one of the circumstances in which a prospectus must be used is where an offer of securities is made to the public in Mauritius. An exemption from this requirement to publish a prospectus applies where offers are made solely to sophisticated investors (which include authorized entities, governments and central banks). However, if the debt securities are to be admitted to trading on the Stock Exchange of Mauritius, a prospectus would still be required.
When is it necessary to prepare a prospectus?

A prospectus is required when an offer of securities is made to the public. There are exemptions to this rule under Mauritius laws.

What are the main exchanges available?

The Stock Exchange of Mauritius

The Stock Exchange of Mauritius operates two markets:

- the Official Market; and
- the Development and the Enterprise Market.

The Official Market

The Official Market, or the Main Board of the Stock Exchange of Mauritius, lists some of the largest companies in Mauritius, spanning across different sectors of activity of the local economy.

The Development and the Enterprise Market

The Development and the Enterprise Market is a market targeted towards small and medium-sized enterprises and newly set-up companies which possess a sound business plan and demonstrate good growth potential.

Is there a private placement market?

There is an active private placement market in Mauritius.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Mauritian law. Mauritius has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under civil law.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Establishing a fund, offering securities in a fund and operating a fund, among other things, are activities requiring a license under the Securities Act 2005 and are regulated by the Financial Services Commission.
What are common fund structures?

Common forms of funds include:

- open-ended funds;
- closed-end funds;
- retail and non-retail funds;
- professional collective investment schemes;
- specialized collective investment schemes (investing in real estate, derivatives, commodities or any other product authorized by the Financial Services Commission); and
- expert funds available only to expert investors.

What are the differences between offering fund securities to professional / institutional or other investors?

Professional Collective Investment Schemes which offer their shares solely to sophisticated investors or as private placements or expert funds which offer their shares solely to expert investors are exempted from most ongoing obligations/regulations generally imposed on collective investment schemes.

Are there any other notable risks or issues around establishing and investing in funds?

Typically, funds are managed by a fund manager, who has the discretion to acquire or dispose of assets using the investor funds in line with a pre-determined investment strategy and subject to safeguards set out in the constitutive documents of the fund and also set out in a fund management agreement.

Fund management requires a license under the Securities Act 2005.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Offering securities is covered by the Securities Act 2005 and guidelines for the advertising and marketing of financial products issued by the Financial Services Commission.

Offering to the public

By virtue of the Securities Act 2005, no person shall make an offer of securities to the public unless:

- the entity whose securities are being offered is in existence at the time of the offer;
- the offer is made in a prospectus that complies with the Securities Act 2005; and
- the Financial Services Commission has given a provisional registration to the prospectus.

Solicitation

Under the Securities Act 2005, solicitation is widely defined.
No person other than the holder of an investment dealer license or an investment advisor, shall solicit another person to enter in securities transactions.

A person shall be deemed to solicit another person where they induces another person to buy, sell or exchange securities or to participate in transactions involving securities or offers persons services, recommendations or advice for those purposes by:

- seeking to meet such person at their place of residence, work or public places;
- contacting such person by telephone, letters, circulars, the internet or other electronic means or telecommunication system; or
- publishing or causing an advertisement to be published or circulated.

**Guidelines for the Advertising and Marketing of Financial Products**

The Financial Services Commission has also provided Guidelines for the Advertising and Marketing of Financial Products, which regulates advertisements in connection with the conduct of an activity or the provision of a service which requires a license, approval, authorization or registration.

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**Are there any restrictions on managing a fund?**

A Collective Investment Scheme Manager shall:

- maintain a minimum unimpaired capital of MUR 1 million (approximately USD27,300);
- observe some prohibitions;
- abide by general rules of conduct;
- have internal control rules;
- contract specific insurance policies;
- abide by standards for publicity and sales literature; and
- keep certain books and records.

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**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

A person entering into a derivatives contract by way of business in Mauritius shall be licensed by the Financial Services Commission.

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**What are common types of derivatives?**

The most common types of derivatives are:

- futures;
- options;
- swaps; and
- forwards.
Are there any other notable risks or issues around entering into derivatives contracts?

Since the financial crisis, the Financial Services Commission has been closely following international developments to keep pace and act accordingly.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending by way of business is a regulated activity and requires a license from the Bank of Mauritius.

Borrowing

Borrowers are not regulated. However, credit facilities not exceeding MUR 3 million (approximately USD82,000) are regulated by the Borrower Protection Act 2007.

What are common lending structures?

Lending can be tailor-made to the requirements of the parties. A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.
Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

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Do the laws recognize the principles of agency and trusts?

Mauritius laws recognize the principles of agency and trust.

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Are there any other notable risks or issues around lending?

Loan agreements are contractual in nature. There are also restrictions on capitalization of interest.

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Are there any other notable risks or issues around borrowing?

Borrowers are afforded very little protection under Mauritius laws in the event of default.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

There are restrictions pertaining to the type of entity taking the security and the type of property which may be given as security.

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What are common types of guarantees and security?

The most common guarantees and security are:

- corporate guarantees;
- personal guarantees;
- fixed/floating charges;
- pledges; and
- mortgages.

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Are there any other notable risks or issues around giving and taking guarantees and security?

The main risk is in the event of insolvency where such guarantee/security will have priority only in accordance with a ranking determined by law which may see a secured creditor rank lower than it would initially rank if not for the insolvency.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Financial Services Act 2007
Securities Act 2005
Investment Promotion Act 2000
Business Facilitation Act 2017
Code of Commerce 1809
Environment Protection Act 2002

Banking

Bank of Mauritius Act 2004
Banking Act 2004

Consumer Credit

Borrower Protection Act 2007
Code Civil Act 1805

Mortgage

Code Civil Act 1805

Corporations

Companies Act 2001
Foundations Act 2012
Limited Partnerships Act 2011
Protected Cell Companies Act 1999

Funds

Securities (Collective Investment Schemes and Closed-end Funds) Regulations 2008
Regulatory authorization

Who are the regulators?

The Financial Services Commission

The Financial Services Commission is the integrated regulator for the non-bank financial services sector and global business.

The Bank of Mauritius

The Bank of Mauritius is the regulator of financial institutions under its purview, namely banks, non-bank deposit-taking institutions, and money changers and foreign exchange dealers.

What are the authorization requirements and process?

Depending on the type of activity to be carried out, applications are made with the Financial Services Commission or the Bank of Mauritius for authorization.

The regulators will assess whether the application meets the applicable criteria and then accept or refuse such application accordingly.

The application fee depends on the type of application, ranging from USD1,000 to USD9,500.

What are the main ongoing compliance requirements?

There are minimum capital requirements which must be met, compliance procedures to be followed and anti-money laundering reporting obligations.

Failure to comply with the above and existing detailed rules and regulations may ultimately result in sanctions by the regulators and a loss of the corresponding license.

What are the penalties for failure to be authorized?

Any person who carries out a regulated activity without a license commits a criminal offense and on conviction is liable to pay a fine not exceeding MUR 1 million (approximately USD27,300) and to imprisonment for a term not exceeding eight years.

Regulated activities

What finance and investment activities require authorization?

Activities regulated by the Financial Services Commission

GENERALLY

No person shall carry out or hold themself as carrying out any financial services in Mauritius without a license issued by the Financial Services Commission.

SPECIFIC ACTIVITIES
These include financial service providers/activities such as distribution of financial products, specialized financial services/institutions, including credit finance and factoring, dealing in, managing, arranging and advising on investments and establishing collective investment schemes and closed-end funds.

**Activities regulated by the Bank of Mauritius**

- Banking Businesses
- Foreign Exchange Dealers
- Money Changers
- Moneylenders
- Non-Bank Deposit-taking institutions

*Are there any possible exemptions?*

**Generally**

There are no general exemptions but discretionary exemptions may be granted by the regulators on a case-by-case basis.

**Moneylending**

There is a list of exemptions provided in the Banking Act 2004 for entities that can carry on the business of moneylending without a license.

*Do any exchange controls or other restrictions on payments apply?*

**Generally**

Any transaction is subject to anti-money laundering laws and tax.

**Exchange Controls**

There are no Mauritius currency exchange restrictions in respect of payments.

**Payments in cash**

Subject to exemptions, any person who makes or accepts any payment in cash in excess of MUR 500,000 (approximately USD15,200) or an equivalent amount in foreign currency, or such amount as may be prescribed, shall commit an offence.

*What are the rules around financial promotions?*

**Solicitation**

Under the Securities Act 2005, solicitation is widely defined.

No person other than the holder of an investment dealer license or an investment advisor, shall solicit another person to enter in securities transactions.
A person shall be deemed to solicit another person where they induces another person to buy, sell or exchange securities or to participate in transactions involving securities or offers services, recommendations or advice for those purposes by:

- seeking to meet such person at their place of residence, work or public places;
- contacting such person by telephone, letters, circulars, the internet or other electronic means or telecommunication system; or
- publishing or causing an advertisement to be published or circulated.

Guidelines for the Advertising and Marketing of Financial Products

The Financial Services Commission has also produced Guidelines for the Advertising and Marketing of Financial Products, which regulates advertisements in connection with the conduct of an activity or the provision of a service which requires a license, approval, authorization or registration.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities used are companies limited by shares. Such companies can be private companies (having less than 50 shareholders) or public companies (having more than 50 shareholders).

Limited Partnerships and trusts are also commonly used.

Funds

Funds and fund managers usually take the form of companies limited by shares. We are seeing an increasing number of shares being set up as limited partnerships.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A company can conduct lending or investment business in Mauritius through a branch but this does not create a separate legal entity.

Foreign companies with a branch in Mauritius need to comply with Part XXII of the Companies Act 2001, which imposes registration, accounting, disclosure, appointment of local agents and other requirements. Such requirements apply only to body corporates. Foreign companies with a place of business or those carrying on business in Mauritius through a permanent establishment will be subject to tax in Mauritius.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being
**developed in the finance and investment marketplace?**

**Peer-to-peer funding platforms and marketplace lending**

There is no definition for marketplace lending under Mauritian Law inasmuch as it is a new area and there is no adequate legal and regulatory framework.

In relation to peer-to-peer lending, the Financial Services Commission, which is the non-bank financial services regulator, has issued a draft Financial Services (Peer-to-Peer Lending) Rules 2017 (P2P Rules) for discussion in or around November 2017.

The aim of these P2P Rules is to, *inter alia*, establish a sound and conducive automated environment or platform for the offer and execution of alternative peer-to-peer lending, other than bank lending, for the benefits of borrowers and stakeholders in the non-banking sector of Mauritius. The small and medium-sized community of entrepreneurs/innovators will be a key category of borrowers targeted by these P2P Rules.

**Blockchain, smart contracts and cryptocurrencies**

To provide an impetus to blockchain and its associated products like smart contracts and cryptocurrencies, Mauritius set up the Mauritius Blockchain Center of Excellence in January 2018, which was a joint initiative of the Office of the President of the Republic of Mauritius in collaboration with the US Embassy.

The aim of this center is to capitalize on the potential of blockchain, which is perhaps the biggest innovation in computer science to date. This new platform is intended to shape the world of finance, business and science as never before and transform the old order for the better.

The mission of the Mauritius Blockchain Center of Excellence will be threefold: blockchain education, community building, and development of use cases, which solve real world problems.

Mauritius aims to leverage its competencies through its ease of conducting business, strategic location, and keenness to advance technology to become a significant blockchain epicenter. The center will collaborate with other stakeholders to bring blockchain expertise to Mauritius and help develop a local blockchain brain trust and opportunities for Mauritius.

Mauritius is further preparing to create an "Ethereum Island" to serve as a hub for innovators from throughout Africa and Asia, through a collaboration between the government of Mauritius and a number of private entities, including ConsenSys, a solutions provider capitalizing on the Ethereum blockchain. As another example, in 2018 Rogers Capital, a Mauritian company, has partnered with BlockCerts, a private blockchain platform, in line with the same vision and even more: expanding blockchain initiatives into Africa.

**Initial coin offerings and token-based products**

ICO and token-based products are still at a very nascent stage in Mauritius but they will be called upon to develop, expand and become crucial in the Mauritian FinTech landscape.

**Artificial intelligence and robo advisory systems**

AI and robo-advisory systems are still at a very nascent stage in Mauritius but they will be called upon to develop, expand and become crucial in the Mauritian FinTech landscape. Regtech is the buzz at the moment and many operators are looking at exploiting this potential.

In November 2018, a report, named *The Mauritius Intelligence Strategy*, issued by the AI Working group commissioned by the government, was published. Its purpose was to show Mauritius’ dedication towards making AI a cornerstone of the next development model by recognizing the potential of the technology to improve growth, productivity and the quality of life. The report makes recommendations to achieve objectives set. The Working group also focused on how to create a regulatory framework to enable the development of AI as well as possible incentives, fiscal or otherwise.

**Data analysis and cloud computing**

Cloud computing is quite prominent in Mauritius and with many back office operations being structured in Mauritius, data analysis is also gaining popularity and momentum.
Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

At the beginning of 2019, the Financial Services Commission stated that the Framework relating to FinTech in Mauritius was finalized. The latter was published via the Government Gazette in March 2019. Throughout this framework, among other initiatives to position Mauritius as the African Fintech Hub, rules regarding the creation of a license for digital asset custodians were set out, a precedent not only in Africa but worldwide.

In its quest to become the blockchain hub of the Indian Ocean, Mauritius also issued an open call for innovators to take advantage of the country's new Regulatory Sandbox License (RSL). The sandbox allows companies operating in areas such as financial, medical and communications technology to start operating despite the absence of a formal legislative or licensing framework. Modeled after similar approaches employed in Australia, Singapore and the UK, the RSL is open to all innovators, but there is an emphasis on attracting blockchain innovators across all verticals. The expectation is that completed projects will help drive domestic and cross-border commerce and eventually expand into a smart city concept that links to other hub cities.

Since launching in November 2016, the RSL has fielded several project proposals, with most under the FinTech umbrella.

To be considered for approval, applicants must demonstrate their project is innovative, beneficial to the Mauritian economy and it cannot be accommodated in the investor's home jurisdiction because of legal or regulatory gaps. Qualified applicants can obtain licensure in as little as 30 days, provided that all relevant information is received and risks are properly addressed.

Electronic payments platforms and regulation of peer-to-peer lenders

The Financial Services Commission, which is the non-bank financial services regulator, has issued a draft Financial Services (Peer-to-Peer Lending) Rules 2017 (P2P Rules) for discussion in or around November 2017.

The aim of these P2P Rules is to, inter alia, establish a sound and conducive automated environment or platform for the offer and execution of alternative peer-to-peer lending, other than bank lending, for the benefits of borrowers and stakeholders in the non-banking sector of Mauritius. The small and medium sized community of entrepreneurs/innovators will be a key category of borrowers targeted by these P2P Rules.

Regulation of payment services

Payment services are regulated in Mauritius by the central bank, the Bank of Mauritius, which has as one of its responsibilities to regulate the banking and credit system to ensure a proper distribution of credit and a sound financial structure.

Application of data protection and consumer laws

The new Data Protection Act 2017 repeals and replaces the previous Data Protection Act 2004. The Data Protection Act 2017 is to a large extent in line with the provisions of European General Data Protection Regulation (GDPR).

Money laundering regulations

Money Laundering is regulated by the Financial Intelligence and Anti Money Laundering Law. This law, inter alia, provides for the offences of money laundering; the reporting of suspicious transactions; the exchange of information in relation to money laundering; mutual assistance with overseas bodies in relation to money laundering; and for matters connected therewith and incidental thereto.

In February 2019, Mauritius was taken out of the European Commission's high-risk third countries list. After undergoing a peer review assessment from the OECD's Forum on Harmful tax Practices, the latter found Mauritius' tax regimes not to be harmful given the changes and steps taken to ensure the compliance of Mauritian provisions with international standards.
What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals, (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

Crowd funding is becoming more prevalent and FinTech startups are having recourse to crowd funding as well in their early stages.

Venture capital and debt

Venture capital funding is a type of equity investment for FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Warehouse and platform funding

Warehouse and platform funding is not common in Mauritius.

Senior bank debt and capital markets funding

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base.

Incentives and reliefs

There is a tax-holiday of eight years for new companies involved in innovation-driven activities on the income derived from the totality of Intellectual Property Assets. Besides that there are no other tax incentives.

Following the Mauritian Budget Highlights 2019/20, further fiscal measures were taken to promote the FinTech field in Mauritius. Thus under the Innovation Box Regime, existing companies will now also benefit from the eight-year income tax holiday on income derived from intellectual property assets developed in Mauritius after June 10, 2019. Peer-to-peer Lending operators will now be granted a five-year tax holiday provided that the company starts its operation before December 31, 2020. Ecommerce platforms will now also benefit from a five-year tax holiday, provided that they are incorporated before June 30, 2025.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

The most common ways of selling loans are:

- novation;
- assignment; and
- sub-participation.

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What are the main considerations when transferring a loan and related security?

The main considerations are as follows:

- confidentiality – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- data protection – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- lender eligibility – whether there are any restrictions around the type of entity to which the loan can be transferred;
- undrawn commitments – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- transfer mechanics – whether there are any steps that need to be taken to transfer the loan in accordance with its terms;
- registration – the costs associated with the registration of such a transfer; and
- consent – whether a transfer requires the consent or notification of any other parties.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Energy and infrastructure assets are both publicly and privately owned. This varies widely depending on the projects. For instance, there are several energy and infrastructure projects which are Public Private Partnerships.

Are there special rules for investing in energy and infrastructure?

There are no special rules for investing in energy and infrastructure, but each project may be subject to regulations and restrictions, for example an Environmental Impact Assessment (EIA) license may be required for certain activities. The application fee for an EIA license is MUR15,000 (approximately USD400).

1An exhaustive list of undertakings requiring an Environmental Impact Assessment can be found in Part B of the Environment Protection Act 2002.

What is the applicable procurement process?

The choice of procurement methods available to a public body is set out below.

Procurement of goods, other services and works

- open advertised bidding;
- restricted bidding;
- request for sealed quotations;
- direct procurement;
• community or end-user participation; or
• departmental execution.

**Procurement of consultancy services**

• request for proposals on the basis of:
  • quality and cost;
  • quality alone;
  • quality and fixed budget; or
  • least cost and acceptable quality;
• direct procurement; or
• open advertised bidding.

**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

Common forms of funding in energy and infrastructure include:

• loans made on a corporate finance basis (balance sheet debt);
• loans made on a project-finance basis (to a special purpose project company) on medium to long-term basis;
• bond finance;
• loans from foreign institutions and countries;
• mezzanine debt (in some sectors);
• refinancing of the debt in operational projects; and
• asset financing (this is particularly relevant in the rail sector).

**Investing**

Common forms of investing in energy and infrastructure include:

• equity investment in special purpose vehicles or entities that may have a portfolio of interests;
• share capital and subordinated sponsor loans; and
• secondary market investment in operational projects (acquisition of equity).

**Restructuring**

**Enforcement and sanctions**

**When can there be regulatory investigations?**

The Financial Services Commission (FSC) is tasked as the regulator to monitor, regulate and supervise Mauritius' non-banking financial
activities.

The FSC will intervene when there are illegal, dishonorable and improper practices, market abuse and financial fraud in relation to any activity in the financial services and global business sectors.

**What regulatory penalties may apply?**

The FSC has powers to impose a range of penalties. These include: giving directions; issuing warnings; issuing public censure; imposing an administrative penalty; revoking a license; disqualifying a licensee from holding a license; and disqualifying the officer of a licensee.

**What criminal penalties may apply?**

The FSC may institute criminal proceedings against any person in respect of any offence under the relevant Acts it manages. This may take the form of fines and/or imprisonment.

**Tax**

**Tax issues**

*Are stamp, registration, transfer or other similar taxes applicable?*

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There are no stamp, registration, transfer or similar taxes payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There is no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a security, unless registration is necessary for the perfection of the security. Securities, such as mortgages or fixed and floating charges, would require the security agreements to be registered and inscribed for the security to be constituted.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

There are no stamp, registration, transfer or similar taxes payable in advance, on transfer or on assignment of a loan unless registration is necessary for the perfection of the security.

**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Secured lenders and secured debt security holders take priority over the Mauritius Revenue Authority on enforcement of security.
Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

No.

What are the key exemptions? For example, is there an exemption for interest payments to banks, to local lenders/debt security holders, on listed debt, to lenders/debt security holders entitled to the benefit of a double tax treaty?

On interest payable by any person, other than by a bank or non-bank deposit taking institution, under the Banking Act, to any person, other than a company resident in Mauritius, a withholding tax of 15% will apply.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

Key contacts

Shalinee Dreepaul
Halkhoree
Partner
Juristconsult Chambers
sdreepaul@juristconsult.com
T: +230 465 0020
Mexico

Capital markets and structured investments

Issuing and investing in debt securities

*Are there any restrictions on issuing debt securities?*

There are restrictions on offering and selling debt securities under Mexican law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Mexico or to request that they are admitted to trading on a regulated market operating in Mexico unless a prospectus approved by CNVB has been made available to the public.

*What are common issuing methods and types of debt securities?*

The main types of debt securities depend on the type of issuer. Typically, banks and other financial institutions issue short-term notes and commercial paper while private companies and local governments issue long-term structured notes under programs.

Debt can be issued under a short (less than a year) or a long (more than a year) term. It can be issued directly as corporate debt (certificados bursátiles, pagarés, obligaciones) (e.g., a bond issuance) or structured debt through a trust (certificados bursátiles fiduciarios).

Debt can be issued in a single series or under a program.

*What are the differences between offering debt securities to institutional/professional or other investors?*

Institutional investors are heavily regulated and subject to the supervision of regulatory authorities including the National Banking and Securities Commission (CNBV), National Retirement Savings System Commission (CONSAR) and Banco de México (BANXICO). Generally, institutional investors can only invest in those assets that applicable regulations explicitly permit.

The Securities Market Law defines institutional investors as any entity which, under federal law, is deemed as such or is a financial entity (that is, Mexican and foreign banks, broker-dealers, insurance companies, AFORES, investment funds, private pension funds, among others), including fiduciary divisions.

*When is it necessary to prepare a prospectus?*
Generally, all debt public offerings require registration with the CNBV and filing a prospectus for approval, except for:

- short-term offerings that require issuers to file only an offering statement (aviso de oferta); and
- issuances under programs, which only require an information memorandum (suplemento) because the prospectus was filed when the relevant program was authorized.

**What are the main exchanges available?**

Currently, the regulated exchanges in Mexico are Bolsa Mexicana de Valores (Mexican Stock Exchange) and Bolsa Institucional de Valores (BIVA).

Since 2014, the Mexican Stock Exchange has been part of the Mercado Integrado Latinoamericano (MILA), an agreement that integrates the stock exchange markets of Chile, Colombia, Mexico, and Peru, as part of economic integration efforts among the Pacific Alliance member countries. MILA is not a regulated stock exchange but an agreement between regulated stock exchanges establishing a regional market to trade equities from the four countries.

In October 2015, BIVA formally applied for a concession to organize and operate a new stock exchange in Mexico, which was granted by the Mexican financial authorities in August 2017.

**Is there a private placement market?**

Mexico has an active private placement market.

**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Mexican law. Mexico has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under Mexican law through a civil action for deceit, negligent misstatement or misrepresentation.

**Investing in debt securities**

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the common representative, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors' interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**

The establishing of an investment fund requires authorization from the National Banking and Securities Commission (CNBV). The
Authorization request is required to include, among other information, a draft copy of the by-laws, the names of the founding shareholders and the members of the board of directors of the management company and a draft copy of the prospectus.

All regulated funds are treated the same way and are referred to as mutual funds in Mexico. Mexican law does not generally distinguish between open-ended and closed-ended funds or retail and hedge funds. They are defined differently under the Investment Funds Law (Ley de Fondos de Inversión): the defining characteristic of an open-ended retail fund is that it has the legal obligation to repurchase or redeem its own shares while it is expressly forbidden for a closed-ended retail fund to repurchase its own shares from its investors if they are not listed on any stock exchange. In practice, closed-ended retail funds are rare in Mexico.

What are common fund structures?

The most popular types of investment funds in Mexico are:

- the variable yield mutual fund or equity mutual fund (Fondo de Inversión de Renta Variable); and
- the mutual fund for investment in debt securities or fixed fund (Fondo de Inversión en Instrumentos de Deuda).

What are the differences between offering fund securities to professional / institutional or other investors?

Generally, Mexican law does not distinguish between the regulation of open-ended and closed-ended funds or retail and institutional/professional funds. Mutual funds can be marketed to both persons and corporations and to the public in general.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

The only legal structure used in Mexico to set up a fund is a stock corporation (Sociedad Anónima or SA). The Investment Funds Law was amended in 2014 to permit the establishment of a special type of SA for mutual funds, so that mutual funds are now required to comply with fewer regulatory requirements.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Investment funds can be marketed by management companies, insurance companies, brokers, brokers' dealers and distributors. These entities must be authorized to market the funds.

The marketing of the investment fund management companies must be clear to avoid confusion and allow for simple interpretation. The broadcasting of announcements with ambiguous information is forbidden. The advertising material must not contain any false information, omission, ambiguity, hyperbole or deception, which might induce the public to make wrong or inaccurate conclusions about the products and services offered by the mutual fund managers.

Although its approval is not required, marketing material must be sent to the National Banking and Securities Commission (CNBV). The Association of Securities Intermediaries (Asociación Mexicana de Intermediarios Bursátiles) (AMIB) can also comment on marketing material.
Are there any restrictions on managing a fund?

Managers of investment funds must be authorized by the National Banking and Securities Commission (CNBV). The portfolio of assets must be deposited in institutions for deposits of securities, which institutions must be licensed.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

In Mexico, entering into derivatives contracts can be carried out in the following markets.

Organized market

In the organized markets, the derivatives contracts are governed pursuant to standardized terms and conditions (active type, underlying, quantity or size of the agreement, expiration of the agreement, price quotations and liquidation procedure). The main feature of these markets is that the seller and the purchaser never trade directly, but through a central counterparty clearing house specialized in derivatives, in order to eliminate the exchange and insolvency risks.

The only institutional, regulated and organized market existing for the trading of derivatives contracts in Mexico is the Mercado Mexicano de Derivados, S.A. de C.V. (MexDer), an affiliate of the Mexican Stock Exchange (Bolsa Mexicana de Valores). MexDer along with Asigna, its triple-A rated clearinghouse (Asigna), offers liquid, transparent Mexican benchmark products based on interest rates, foreign exchange and stock indexes. Asigna acts as a counterpart for all transactions performed on MexDer.

In principle, to trade directly in MexDer, it is required to be:

- a Clearing Member (Socio Liquidador), which is a trust that is a member of MexDer and owns a share in the equity of Asigna, and whose purpose is to settle and, in some cases, enter into exchange-listed futures and option contracts on behalf of clients; or
- a Trader, which is a bank, brokerage firm or any other entity, that may or may not be a member of MexDer, whose purpose is to act as a broker for one or more clearing members in entering into futures and option contracts, and which may access MexDer’s electronic trading system to enter into such contracts.

Over the counter (OTC)

In the non-organized markets, the parties set out the relevant terms and conditions in accordance with their particular needs; the derivatives contracts are designed by institutions pursuant to the particular needs of their clients. In these markets, there is no clearing house and thus each party takes default risk. In the OTC, there are absolutely no limitations regarding the type of derivatives products to be commercialized, as long as there are assets, trade flows or goods that may allow the documentation of such transactions.

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What are common types of derivatives?

In MexDer, only future, options and interest rate swap agreements are listed. Only futures and options with the following underlying assets are eligible:

- futures – foreign currency, indexes, debt, shares and commodities; and
- options – foreign currency, indexes, and shares.

All other types of derivatives contracts (including forwards and currency swaps) are privately negotiated in non-exchange-traded market transactions (OTC or Over the Counter).

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Are there any other notable risks or issues around entering into derivatives contracts?

The derivatives market regulation relies on general provisions encompassing the Ministry of Finance and Public Credit (SHCP), Banco de México (BANXICO) and the National Banking and Securities Commission (CNBV). There is no regulation for OTC derivatives, which impairs enforcement and supervisory efforts by CNBV in this area, however, the CNBV aims at maintaining oversight of OTC derivatives transactions to ensure that participants do not engage in regulated activities, such as trading with securities.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the National Banking and Securities Commission to conduct such business. The main provisions regulating these activities aim at protecting financial services users, strengthening competition in banking services, and giving the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF) powers to supervise and impose sanctions.

There are no additional restrictions that apply to foreign lenders making loans to Mexican borrowers.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

What are common lending structures?

Lending in Mexico can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities and project or letter of credit facilities.

Loan durations

The duration of a loan can vary between:

- a term loan, provided for an agreed final period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
• an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
• a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

**Loan commitment**

A loan can be:

• committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

**Loan repayment**

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

*Last modified 5 Dec 2019*

**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity supervised by the National Banking and Securities Commission (CNBV) and the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF).

For more information, see Lending and borrowing – restrictions.

*Last modified 5 Dec 2019*

**Do the laws recognize the principles of agency and trusts?**

It is common to appoint an agent to act on behalf of other parties (as in syndicated loan transactions) and a trustee to hold rights and other assets on trust for the lenders or secured parties. Thus, the common-law principles of agency and trust are recognized in the Mexican legal framework.

*Last modified 5 Dec 2019*

**Are there any other notable risks or issues around lending?**

**Generally**

Loan agreements and other finance documents are subject to general contractual principles. There are no specific limitations on interest rates or the ability of lenders to charge default interest under loan agreements, however, there may be general or practical limitations stemming from usury statutes, judicial precedents and market conditions that may limit the amount of the rate as well as from tax considerations, particularly in the case of transactions among related parties.

In the event of proceedings in Mexico seeking performance of obligations of a Mexican borrower, pursuant to Mexican Monetary Law, the borrower may discharge its respective obligations by paying any sums due in a currency other than Mexican currency, in Mexican currency at the rate of exchange prevailing in Mexico and fixed and published by Banco de México (BANXICO) in the Official Gazette of the Federation of Mexico on the date preceding the date of payment.
**Specific types of lending**

In mortgage and consumer lending, the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF) is granted authority to provide for a list of 'abusive clauses' which institutions will not be able to include in their adhesion contracts, as well as the regime for its supervision and removal. Financial adhesion contracts are non-negotiable financial contracts which are offered by financial institutions and accepted 'as is' by financial services users seeking the corresponding financial service.

**Standard form documentation**

There are no recommended forms of lending documentation provided by market participants or regulators. Most finance transactions are documented on bank standard form documentation prepared in-house or by external legal counsel.

*Last modified 5 Dec 2019*

**Are there any other notable risks or issues around borrowing?**

In cross-border lending, borrowers are required to consider the identity of the beneficial owner of interest payments, given that tax gross-up clauses are a common feature in loan agreements and withholding tax rates range from 4.9% to 40%, depending on the beneficial owner of the interest. Lower withholding tax rates may be available to tax residents in countries with which Mexico has entered into a tax treaty to avoid double taxation. Interest payments carried out to export-import banks may not be subject to any withholding, provided that the conditions set out by the relevant tax treaty are complied with.

*Last modified 5 Dec 2019*

**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**

Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the signatories’ powers that would prevent them from executing such documents.

**Insolvency**

Guarantees and security may be at risk of being set aside under Mexican insolvency laws if the guarantee or security was granted by a company with a certain period of time prior to the onset of insolvency (fraudulent conveyance). This would be the case if the company giving the guarantee or security received considerably less consideration, and as such, the transaction was at an undervalue. For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within 270 calendar days prior to the declaration of insolvency of the affected party (or 540 calendar days for inter-company claims). Guarantees and security may also be challenged on other grounds relating to insolvency.

**Financial assistance**

The concept of unlawful financial assistance is not recognized in Mexico. However, fair consideration, corporate benefit, arms-length transactions and related concepts are relevant, particularly in insolvency situations.

**Corporate benefit rules**

The granting of downstream guarantees and security interests by a parent company to secure a loan to its subsidiary would generally be valid.

*Last modified 5 Dec 2019*
What are common types of guarantees and security?

Common forms of guarantees

Guarantees to secure compliance with obligations are commonly used in Mexico in all types of transactions. The most common types of guarantees are as follows.

CIVIL GUARANTEE (FIANZA CIVIL)

The Federal Civil Code establishes that the civil guarantee is an agreement by means of which a third party undertakes to pay the creditor if the debtor does not meet its obligations.

SURETY BOND (FIANZA MERCANTIL)

Under Mexican law, a bond is a guarantee issued by an authorized entity which grants bonds on a customary basis. The bond is an agreement between a guarantor and the creditor of the original debtor under which the guarantor undertakes to pay or otherwise comply with the debtor's obligations in case the debtor defaults. The bond can be granted only if a valid underlying obligation exists. A guarantor may validly agree to pay a certain amount of money which is owed and not paid by the debtor, or if the debtor does not comply with a payment obligation.

Surety bonds can be of various types, including administrative, judicial, credit and fidelity bonds.

UNCONDITIONAL ENDORSEMENT (AVAL)

According to the General Law of Negotiable Instruments and Credit Operations, a person may guarantee total or partial payment of amounts described in a negotiable instrument (e.g., promissory note) by means of an unconditional endorsement. The guarantor is jointly liable with the principal obligor and its obligations are valid notwithstanding that the principal obligation is null for any reason whatsoever.

Common forms of security

The most common forms of security are as follows.

MORTGAGE

A mortgage is a security interest granted over real estate assets that are not delivered to the creditor, and that give the creditor the right (in case of default of the secured obligation) to be paid from the value of the asset.

GUARANTEE TRUST

This is a contract under which a person transfers to a trustee the ownership or title of one or more tangible and/or intangible assets in order to secure the obligations of a settlor in favor of a third party.

TRADITIONAL PLEDGE (PRENDA MERCANTIL)

The pledgor (a debtor or a third party) transfers possession of the movable asset to the lender (or a third party for the benefit of the lender) to hold as security for compliance with an obligation. This pledge is commonly used to pledge stock of a private company, for instance, where the lender takes actual possession of endorsed stock certificates.

NON-POSSESSORY PLEDGE (PRENDA SIN TRANSMISIÓN DE POSESIÓN)

Possession and operation of the assets remain with the pledgor. This type of pledge includes the possibility of creating a floating or generic pledge over all present and future movable assets of a business.

SECURITIES PLEDGE (PRENDA BURSÁTIL)

This is a pledge over securities traded in the Mexican stock exchange. Securities are deposited in an account at the S.D. Indeval, S.A. de C.V., Institución para el Depósito de Valores (clearing agency).
Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

A civil guarantee cannot exist without a valid principal obligation. Guarantors are granted certain benefits under Mexican law, known as the benefits of orden, división and excusión. The benefit of orden requires the creditor to proceed against the debtor before proceeding against the guarantor. The benefit of excusión requires the creditor to ensure the assets of the debtor are first exhausted in payment of its obligations before any amounts are claimed from or paid by the guarantor. The benefit of división exists when there are multiple guarantors: it allows one of the guarantors which has been called to trial to have the other guarantors appear at the same trial in order to defend themselves jointly, with each guarantor being liable for its proportionate share of the principal obligation. These benefits may be waived by the guarantor.

Giving or taking security

A mortgage securing a debt above a minimum threshold value (which is determined by local law and varies from state to state) must be in writing and executed before a Mexican notary public. The mortgage instrument, which should precisely describe the property being encumbered and the term of the mortgage, must be registered in the appropriate real property public registry office to be effective against third parties. Other registrations are required depending on the type of property being encumbered. For example, registration in the aircraft registry, the maritime registry and the railroad registry.

Guarantee trusts must be executed in writing. A guarantee trust over immovable property must be executed before a Mexican notary public and the trust instrument must be registered in the appropriate real property public registry office to be effective against third parties. Guarantee trusts over movable property securing a debt above a minimum threshold value must also be executed before a Mexican notary public and the trust instrument should be registered in the federal personal property collateral registry (Registro Único de Garantías Mobiliarias). Other registrations, authorizations and additional actions can also be required depending on the assets being placed in trust.

A traditional pledge must be executed in writing. Special perfection requirements apply depending on the type of asset, such as delivery of bearer instruments to the lender or a third party, delivery and endorsement of registered instruments and registration in the special registry ledger (for example, in the case of shares of a private stock corporation), and delivery of non-negotiable instruments and notices to the underlying debtor, if applicable.

A non-possessory pledge must be executed in writing. A non-possessory pledge securing a debt above a minimum threshold value must be ratified before a Mexican notary public and the resulting instrument registered in the the federal personal property collateral registry (Registro Único de Garantías Mobiliarias) to be effective against third parties.

A securities pledge must be executed in writing and involves a foreclosure agent (executor) and the transfer of the securities to an account at the clearing agency. A Mexican bank or brokerage firm (other than the lender) may be appointed as foreclosure agent and is responsible for selling the securities at market value if a default occurs.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally
Bank of Mexico Law (Ley del Banco de México)
Credit Institutions Law (Ley de Instituciones de Crédito)
Securities Market Law (Ley del Mercado de Valores)
Financial Groups Law (Ley para Regular las Agrupaciones Financieras)
Credit Organizations and Auxiliary Activities General Law (Ley General de Organizaciones y Actividades Auxiliares del Crédito)
General Law of Negotiable Instruments and Credit Transactions (Ley General de Títulos y Operaciones de Crédito)

Consumer credit

Law for the Protection and Defense of the User of Financial Services (Ley de Protección y Defensa al Usuario de Servicios Financieros)
Financial Services Transparency and Regulation Law (Ley para la Transparencia y Ordenamiento de los Servicios Financieros)

Mortgages

State Civil Codes (Códigos Civiles Estatales)

Special types of mortgages regulated in the following laws:

- Credit Institutions Law (Ley de Instituciones de Crédito) (Industrial Mortgage);
- Civil Aviation Law (Ley de Aviación Civil) (Aircraft Mortgage);
- Maritime Navigation and Commerce Law (Ley de Navegación y Comercio Marítimos) (Maritime Mortgage); and
- General Communications Law (Ley de Vías Generales de Comunicación) (Communications Assets Mortgage)

Corporations

General Law of Commercial Companies (Ley General de Sociedades Mercantiles)
Securities Market Law (Ley del Mercado de Valores)

Funds and platforms

Investment Funds Law (Ley de Fondos de Inversión)

Other key market legislation

Monetary Law of the United Mexican States (Ley Monetaria de los Estados Unidos Mexicanos)
Financial Technology Institutions Law (Ley para Regular las Instituciones de Tecnología Financiera)
Payments Systems Law (Ley de Sistemas de Pagos)
Bankruptcy Law (Ley de Concursos Mercantiles)
Bank Savings Protection Law (Ley de Protección al Ahorro Bancario)
Law to Regulate Credit Information Corporations (Ley para Regular las Sociedades de Información Crediticia)
Guaranteed Credit Transparency Law (Ley de Transparencia y de Fomento a la Competencia en el Crédito Garantizado)
Anti-Money Laundering Law (Ley Federal para la Prevención e Identificación de Operaciones con Recursos de Procedencia Ilícita)
Several regulations (circulars) issued by Banco de México, the National Banking and Securities Commission and other regulatory bodies

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Regulatory authorization

Who are the regulators?

The Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público) (SHCP) plans and directs the Federal Government's economic policy in Mexico, as regards to finance, tax, spending, income and public debt. It supervises the Mexican banking system.

Mexico's central bank, Banco de México (BANXICO), promotes the sound development of the Mexican financial system and the optimal
functioning of the payment systems. BANXICO ensures the stability of the domestic currency's purchasing power.

The National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) (CNBV), supervises and regulates all entities of the Mexican financial system (including banks, non-bank finance companies, stockbrokerage houses, financial technology institutions and mutual funds) in order to ensure its stability and proper operation and to protect the interests of the general public.

The National Commission for the Protection and Defense of Users of Financial Services (Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros) (Condusef), promotes financial education and transparency and protects financial services users before entities of the Mexican financial system.

The National Retirement Savings System Commission (Comisión Nacional de Sistemas de Ahorro para el Retiro) (CONSAR), supervises and regulates AFOREs, companies that administer the employees retirement savings.

The Bank Savings Protection Institute (Instituto para la Protección al Ahorro Bancario) has the authority to provide depositary insured institutions with limited deposit insurance in favor of banking depositors and suggest and oversee capital restoration plans to financially assist banks for the benefit of depositors.

The National Insurance and Bonding Commission (Comisión Nacional de Seguros y Fianzas), supervises and regulates insurance and bonding companies.

What are the authorization requirements and process?

Most financial entities require authorization for incorporation from CNBV (in some cases with an opinion from BANXICO confirming such entity's suitability for authorization).

The authorization process includes identifying equity holders, board members and main officers, presenting a business plan and a draft copy of by-laws, describing the proposed capital structure, describing technological infrastructure and identifying the origin of resources used as capital contributions. In most cases the regulator will have three to six months from receipt of a completed application to grant or deny authorization.

Most institutions are required to make a security deposit in favor of the Federal Treasury, representing a percentage of the corresponding institution's minimum capital requirement.

Most authorized financial institutions are listed in the Supervised Entities Registry (Padrón de Entidades Supervisadas).

What are the main ongoing compliance requirements?

Financial institutions are subject to prudential supervision (eg capital adequacy, liquidity, operational and technological risk) and requirements on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), protection of users of financial services and efficiency of operation and competition in financial services.

What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized commits a criminal offence and is liable to imprisonment.

Regulated activities

What finance and investment activities require authorization?
Generally

Main regulated activities include:

- retail banking activities (operation of deposit accounts);
- consumer lending;
- public offering of securities;
- crowdfunding and electronic wallets;
- securities brokerage (trading in securities and other investments);
- investment and asset management (managing investment funds, including distribution and appraisal entities);
- insurance and bonding issuance and brokerage;
- establishment of representative office of foreign financial institutions; and
- investment advisory services (rendering portfolio management and investment advisory services in a regular and professional manner).

Consumer credit

Consumer lending is also a regulated activity that requires governmental authorization.

Are there any possible exemptions?

Mexican Non-Bank Financial Entities (Sociedades Financieras de Objeto Múltiple or SOFOMs) are allowed to provide financing through direct loans, financial leasing and factoring without needing to obtain authorization from Mexican regulators, however, these entities are not allowed to obtain deposits from the general public. There are two types of SOFOMs:

- regulated SOFOMs which are entities with a capital link to a banking or other regulated institution; and
- non-regulated SOFOMs which lack such a capital link.

For each type of regulated activity there are a number of specific exemptions that could also apply, including for activities carried out by family offices, private equity entities and other private wealth management entities.

Do any exchange controls or other restrictions on payments apply?

The Mexican peso is freely convertible into all other currencies and there are no restrictions on the remittance of profits abroad or the repatriation of capital.

What are the rules around financial promotions?

Rules

Mexican legislation regulates investment advisors as individual or entities that without being stock exchange brokers, provide portfolio management and investment advisory services in an habitual and professional manner. Investment advisors are subject to the surveillance of the National Banking and Securities Commission (CNBV) and subject to AML/CFT regulations.

All advertising or promotion by investment advisors to the general public is subject to CNBV's approval, including advertising in...
connection with securities offers, which is made through prospectuses, informative brochures or other offering materials authorized by CNBV.

Exemptions

Exemptions include communications to relatives or employees, foreign investment advisors not having physical presence or agents in Mexico, or the rendering of asset management services to trusts issuing securities to the general public though the stock exchange, as long as there is no services advertisement to an indeterminate number of persons or through mass media.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common type of legal entity is the stock corporation or Sociedad Anonima, which can adopt the variable capital form in order to be a Sociedad Anonima de Capital Variable, the only difference being the flexibility in the latter to increase or decrease its capital stock without having to amend formally its corporate charter.

The Sociedad Anonima are required to adopt the Sociedad Anonima Bursatil or Sociedad Anonima Promotora de Inversión Bursátil forms form when performing an initial public offer of their shares though the Mexican Stock Exchange.

Funds

Investment funds are required to adopt the Sociedad Anonima de Capital Variable form of entity.

Is it possible to conduct lending or investment business through a branch or establishment?

Foreign lenders are able to conduct lending activities in Mexico through a branch or office outside of Mexico.

Foreign financial institutions may conduct lending or investment business by establishing in Mexico affiliates of foreign financial institutions.

Foreign financial institutions may also establish a representative office in Mexico through which they may perform a limited list of activities, including informing and negotiating the terms and conditions of loans and investments to be made by foreign financial institutions. Specific prohibitions are applicable to representative offices such as undertaking any financial intermediation that would require authorization from the Mexican government or acting in transactions that imply the receipt of funds or investments from the public.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?
Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending in Mexico is at an initial stage but has made available most forms of traditional bank funding products. Most common products include:

- debt consolidation;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- factoring.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P) type structures, often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Marketplace lending businesses can be incorporated under various corporate forms, often as stock corporations (sociedad anónima or SA) – or one of its variations, the investment promotion corporation (sociedad anónima promotora de inversión or SAPI) – which provide flexibility and corporate governance features that facilitate joint venture arrangements and private equity investments. There is also an example of a marketplace lender incorporated as a Popular Finance Company (sociedad financiera popular or SOFIPO), a microcredit financial institution authorized and supervised by Mexico's National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores or CNBV).

Most marketplace lenders operate as agents of investors to make loans on their behalf to third parties interested in obtaining financing. The loan funds are provided by the investors; the marketplace lender then distributes the funds on behalf of investors to various pre-qualified borrowers and also acts as agent of the investors for administrative and collection purposes.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored on the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties
to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record, for example, relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The Financial Technology Law bill (Ley de Tecnología Financiera or LTF) that regulates the FinTech industry in Mexico, indicates that virtual assets, including cryptocurrency, will be defined by Mexico’s Central Bank. However it is understood that these virtual assets will be a representation of verifiable digital value that is neither issued nor backed by a central bank or financial entity; that is, they are not legal tender, however they generate units for exchange, given its acceptance by the general public. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of
access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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_Last modified 5 Dec 2019_

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

Financial Technology Institutions Law (Ley de Tecnología Financiera or LTF) was published on March 9, 2018, in the Official Gazette of the Federation.
GENERAL

FinTech companies in Mexico will need to be analyzed carefully to verify whether it falls under the scope of financial regulations requiring such activities to be carried on by authorized and supervised entities. Relevant regulations include those relating to banking, securities brokerage, insurance, and fund formation, among other services.

The Comisión Nacional Bancaria y de Valores (CNBV) supervises and regulates all entities in the Mexican financial system –including banks, non-bank finance companies, stockbrokerage houses, and mutual funds – in order to ensure its stability and proper operation as well as to protect the interests of the general public. Most financial entities require authorization for incorporation from CNBV (in some cases with an opinion from Mexico's Central Bank – Banco de México or BANXICO).

REGULATORY DEVELOPMENTS

The main elements of the Financial Technology Institutions Law (Ley de Tecnología Financiera or LTF) are:

- **principles** – financial inclusion, consumer protection, financial stability, promotion of competition and prevention of money laundering and financing of terrorism;
- **regulated Financial Technology Institutions (FTIs)** –
  - crowdfunding institutions (instituciones de financiamiento colectivo);
  - electronic payment institutions (instituciones de fondos de pagos electrónicos); and
  - regulatory sandboxes/innovative companies (empresas innovadoras);
- **authorization of FTIs** – to be granted discretionally by the CNBV, with prior approval by the Financial Technology Committee which will be formed by officers of BANXICO, CNBV and the Ministry of Finance;
- **corporate governance** – FTIs will have to be incorporated as Mexican stock corporations (sociedad anónima or SA) or limited liability companies (sociedad de responsabilidad limitada or Sde RL) in order to provide services in Mexico (CNBV will issue regulations on board of directors, officers and committee requirements for FTIs);
- **regulatory sandbox** – innovative companies that obtain a temporary authorization (up to two years) to provide services to a reduced number of clients to test innovative products, services, business models and delivery mechanisms; and
- **a Fintech Council** – the draft bill provides for the creation of a FinTech Council to act as a means of consultation, advice and coordination between public and private sectors.

Crowdfunding institutions

The LTF defines crowdfunding institutions as those that regularly and professionally carry out activities with the purpose of connecting an investor (funds provider) and an applicant (funds requester), through interfaces, websites or any other digital or electronic means of communication.

Crowdfunding institutions may perform the following activities:

- **debt-based crowdfunding** – loans or any other type of financing by investors resulting in a direct or contingent liability of applicants;
- **equity-based crowdfunding** – acquisition on instruments by investors representing the capital stock of applicants; or
- **royalty-based crowdfunding** – acquisition by investors of a portion or share of a present or future asset, or the income, profits, royalties or losses resulting from projects developed by applicants.

Electronic payment institutions

The LTF defines electronic payment institutions as those institutions which regularly and professionally carry out activities through interfaces, websites or any other digital or electronic means of communication, consisting in the issuance, management, redemption and transfer of electronic payment funds, by opening accounts for their clients to make deposits in exchange of electronic payment funds, making transfers to different accounts, and delivering money in amounts equivalent to the electronic payment funds withdrawn from the relevant account.
Electronic payment funds will be those funds that:

- are linked to monetary value equivalent to an amount in Mexican pesos or virtual assets;
- result in a payment obligation against the electronic payment institution;
- are issued against receipt of an amount of money or virtual assets; and
- are accepted by a third party as money or virtual assets.

Application of data protection and consumer laws

Pursuant to the Federal Law on Protection of Personal Data Held by Private Parties (Ley Federal de Protección de Datos Personales en Posesión de los Particulares or Privacy Law), in the processing of personal data, the person or entity collecting personal data (data controller) must provide a privacy notice (Aviso de Privacidad or the Privacy Notice), which must be made available to the data owner prior to the processing of his or her personal data.

The term ‘processing’ is broadly defined in the Privacy Law to include the collection, use, communication, or storage of personal data by any means. Use includes all access, management, procurement, transfer and disposal of personal data.

Consent is required for all processing of personal data, except as otherwise provided by the Privacy Law. Implicit consent (notice and opt out) applies to the processing of personal data; express consent (notice and opt in) applies to the processing of financial or asset data; and express and written consent applies to the processing of sensitive personal data. Consent may be communicated verbally, in writing, by electronic or optical means, via any other technology, or by any other unmistakable indications. Express written consent may be obtained through the data owner's written signature, electronic signature, or any other authentication mechanism set up for such purpose.

The Financial Services Consumer Protection Law (Ley de Protección y Defensa al Usuario de Servicios Financieros) and the Federal Law on Consumer Protection (Ley Federal de Protección al Consumidor) provide that product information and fees must be available to consumers.

Money laundering regulations

The Mexican anti-money laundering law (Ley Federal para la Prevención e Identificación de Operaciones con Recursos de Procedencia Ilícita) and its regulations apply to FinTech entities performing activities listed in such law as vulnerable activities. FinTech entities which fall within the scope of the regulations are required to verify the client's identity, any beneficiaries of transactions, register with the regulators and file monthly reports, among other requirements.

The LTF proposes that full identification of investors and applicants will be required and will further require FTIs to only use banks accounts with authorized financial institutions to receive and transfer funds to their clients and the use of cash would be limited to specific situations authorized by CNBV, taking into account the particular business model of the FinTech entity and the establishing of appropriate limits.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as angel investors) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING
The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdfunder.mx and Play Business.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

There are various incubators or accelerators in the Mexican market which offer support, facilities and funding for startups, often in return for an equity stake. For example, the Startup Bootcamp Fintech has an accelerator program which offers entrepreneurs free office space, mentorship, global network access, and funding. It is a joint venture between Startupbootcamp and Finnovista (another leading platform for accelerating FinTech innovation in Latin America); and they are supported by leading institutions such as Visa, BanRegio, Gentera and EY.

In early 2013, the Mexican Government created the National Entrepreneur Institute (Instituto Nacional del Emprendedor or INADEM), an administrative body within the Ministry of Economy specifically aimed at developing a stronger entrepreneurial ecosystem. INADEM administers the National Entrepreneur Fund (Fondo Nacional Emprendedor) which is open to support FinTech companies. Some states in Mexico also provide certain incentives and have their own entrepreneurship institutes providing different types of support to the FinTech sector.

Venture capital and debt

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions. There are various examples of Mexican FinTech companies receiving venture capital, such as Kueski (lending platform), Konfio (lending platform), Clip (payment processor platform) and Kubo Financiero (peer-to-peer (P2P) lending platform).

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor. Some of the big corporates in Mexico have started to follow this global practice, albeit through accelerators. Companies such as Telefónica, Cinépolis, Volaris, Axtel, Coca-Cola, Grupo Expansión, Hoteles City Express, Ternium, and Banregio have established initiatives to interact with startups. An active player in Mexico is Telefonica's Wayra.

An additional funding option is venture debt, which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital. This alternative is still not common in the FinTech sector in Mexico.

Warehouse and platform funding

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator. Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date. This alternative is still not common in the FinTech sector in Mexico.

Another alternative form of funding is by way of P2P lending platforms such as Kubo Financiero, Prestadero and Doopla, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments; interest is paid on the money borrowed instead.

Senior bank debt and capital markets funding
SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Mexico has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) has not been a funding option for FinTech companies in Mexico given that they have not reached the size required for an IPO to become available. An IPO is the initial sale of company shares on a public exchange, such as the Mexican Stock Exchange (MSE), currently the only stock exchange operating in Mexico. On 29 August 2017, the Mexican Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público) granted Central de Corretajes (CENCOR) a new concession to operate a new stock exchange in Mexico, which will operate under the name of Bolsa Institucional de Valores (BIVA) and will be supported technologically by NASDAQ. It is anticipated that BIVA will initiate operations in early 2018. It is expected that BIVA will be targeting smaller companies than those listed in the MSE, providing better chances for IPO funding to FinTech companies in Mexico.

FinTech companies in Mexico have not explored funding alternatives through debt capital markets, although there are various alternatives available, such as bonds and securitizations.

CONVERTIBLE BONDS/LOAN NOTES

A funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes, which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances. Mexican FinTech companies have started to explore this funding alternative, such as Kueski, a leading online lending platform in Mexico.

Incentives and reliefs

The Mexican Income Tax Law provides a 30% tax credit for research and development (R&D) expenses, including investments in R&D. The tax credit will be equal to current-year R&D expenses in excess of the average R&D expenses incurred in the previous three years. This incentive cannot be combined with other tax incentives.

There is a wide variety of targeted incentives that encourage specific types of economic development, however, FinTech-specific incentive programs are scarce. Prosoft is an initiative aimed at developing a strong, competitive, and global IT sector in Mexico, by supporting companies from strategic sectors to develop innovation ecosystems through collaborations among private sector, government, and the academic sector. The initiative is managed by the Ministry of Economy and provides cash grants for up to 70% of eligible expenses.

Local governments also provide certain incentives that are available to FinTech companies in Mexico.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common. A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common way of selling loans is through an assignment of all of the assignor’s rights and obligations under the corresponding loans, including any promissory notes documenting disbursements (or its substitution).

Participations in loans are also common as a way of lenders transferring an economic interest in a loan but not changing the legal
relationship between the existing lender and borrower under a loan agreement.

The form and content of the transfer documentation will depend on the nature of the loans being sold. It is customary for the parties to include a template of assignment agreement as an exhibit to the loan agreement.

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**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

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**Projects**

**Financing / investing in energy / infrastructure**

**To what extent are energy and infrastructure assets publicly or privately owned?**

**Generally**

The ownership of energy and infrastructure assets in Mexico varies according to the asset class. Subsurface rights belong to the Mexican state and the Mexican government may grant concessions to use subsurface land for mining, oil and gas drilling and production or for geothermal exploration and production, among others.

**Energy**

Deriving from a comprehensive Energy Reform in 2013, which involved changes at both constitutional and secondary legislation levels, a new legal framework was put in place for the energy sector.

Underground hydrocarbons, including oil and gas, are government-owned property and no private property in hydrocarbons is allowed. However, deriving from the Energy Reform, oil and gas activities such as exploration, production, treatment, refining, processing, storage, transportation and commercialization, were opened to the private sector. Private sector companies are now allowed to participate in exploration and extraction activities and ownership of extracted hydrocarbons is permitted in production sharing and license contracts, in which part of the production is given to the contractor. Owners of land where underground hydrocarbons are discovered are entitled to remuneration from commercial production of the discovered wells. The Hydrocarbons Law provides that landowners may receive a percentage of the contractor’s profit. *Petróleos Mexicanos* (Pemex), the state-owned petroleum company, continues to participate in the sector but as an additional player within the blocks awarded to Pemex through entitlements, which provide Pemex the right to explore and/or produce hydrocarbons directly, or through farm-outs or PPPs.

The Electric Industry Law allows the private sector to participate freely in the generation and sale of electricity and the construction of transmission and distribution infrastructure, while maintaining the electricity grid under the operational control of the Federal Electricity...
Commission (CFE), the state-owned public utility. The new legal framework has created a wholesale electricity market operated by the National Centre for Energy Control (CENACE) as a single independent system operator for the entire grid. Market participants are now able to sell and purchase power directly in the market or through bilateral PPAs, including those awarded through auctions. Operational control of the national grid and the transmission and distribution of electricity are considered strategic areas that remain in the hands of the Mexican government. However, the private sector is able to participate in the transmission and distribution of electricity through agreements and joint ventures with state-owned enterprises. CFE is permitted to participate, through separate subsidiaries, in the different market activities, and is the supplier of basic retail services to residential customers and small and medium-sized commercial customers under regulated tariffs. Nuclear power generation remains under the control of the Mexican government.

**Telecoms infrastructure**

The legal framework for the telecoms and broadcasting sectors is set out in the new Federal Law of Telecommunications and Broadcasting (Ley Federal de Telecomunicaciones y Radiodifusión) (FLTB), which came into force on August 2014. The FLTB states that telecommunications and broadcasting activities are a ‘public service of general interest’, and that the government will at all times maintain the ownership of the radio spectrum. The Federal Government may grant two types of concessions to private sector companies:

- ‘all-inclusive concessions’, which authorize concessionaires to provide all sorts of telecommunication or broadcasting services through their network and that according to their use may be classified as commercial, public, social or private; and
- concessions to use radio-electric spectrum or orbital resources.

**Transport infrastructure**

**RAIL**

Mexican railway lines are owned by the government, which means that only the state can build new railway links. However, the rail service was privatized about 20 years ago dividing the country's railways into different regions and putting them under private management through concessions for up to 50 years.

**URBAN RAIL TRANSIT**

- **Mexico City Metro System** – owned and operated by the Mexico City Government
- **Monterrey Metro System** – owned and operated by the Government of the State of Nuevo León
- **Xochimilco Light Rail** – owned and operated by the Mexico City Government
- **Guadalajara Light Rail** – owned and operated by the Government of the State of Jalisco
- **Suburban Railway of the Valley of Mexico Metropolitan Area** – owned by the Federal Government, built and operated by private sector company under a 30-year concession, and required the collaboration of the Federal, Mexico City, State of Mexico and municipal governments
- **Interurban Train Mexico City–Toluca (under construction)** – owned by the Federal Government, in collaboration with the Mexico City Government, its construction is by private sector companies through public works contracts

**ROADS, BRIDGES AND TUNNELS**

The highway system of Mexico is made up of federal highways, state highways, and rural roads. Federal highways are those that connect with roads from foreign countries, link two or more states of the Federation, and are wholly or mostly built by the Federation with federal funds or through federal concessions by individuals, states, or municipalities. State highways and rural roads are the responsibility of state governments.

_Caminos y Puentes Federales de Ingresos y Servicios Conexos_ (CAPUFE), a government agency under the Ministry of Communications and Transportation (SCT), is in charge of the operation and maintenance of federal roads and bridges, including those under concessions granted to third parties that engage CAPUFE for such services.

**AVIATION**

Aviation for the most part is privatized in Mexico. However, the administration, control and surveillance of airports is restricted to the
federal government. There are certain public bodies (such as Aeropuertos y Servicios Auxiliares – ASA) that participate either with another authority (i.e., state government) or with the private sector to build, maintain, and operate airports across Mexico. Other airport facilities are operated by the Ministry of Defense, the Navy, and municipal authorities.

PORTS

Mexican port privatization started in 1993 with a new Ports Law which dismantled the public port agency (Puertos Mexicanos) and created Independent Port Administrations (Administraciones Portuarias Integrales – API) at each port or group of small ports. APIs are commercial entities controlled by the federal government, the state governments, the National Tourism Fund, and in one case by private capital. Every activity related to port administration, operation, and services is under supervision of the federal government, however, APIs are granted concessions for the use and management of ports and can themselves transfer rights or grant specific services contracts to private sector terminal operators in order to supply port services. The Coordinación General de Puertos y Marina Mercante, under the authority and supervision of the Ministry of Communications and Transportation, has the authority on regulation and administration of ports in Mexico.

Other infrastructure

SOCIAL INFRASTRUCTURE

Most of the social infrastructure is financed by federal or state governments. In particular, public hospitals, prisons, and schools are managed by the Ministry of Health, Ministry of Interior, and the Ministry of Education, respectively. However, for the design, construction and maintenance, the relevant authority will enter into an agreement with the private sector through a bidding process or a public-private partnership. For social housing, in broad terms, the private sector develops the real estate projects for social housing (either by private or public funding), then employees obtain a mortgage from the National Workers’ Housing Fund Institute (Instituto del Fondo Nacional de la Vivienda para los Trabajadores) (INFONAVIT) to be repaid with payroll deductions that employers make and forward to INFONAVIT, as well as mandated contributions that employers make to INFONAVIT as a percentage of each worker’s salary.

DEFENSE

Generally, defense assets are owned by the federal government.

WASTE

The waste management is the responsibility of each local government. The municipal authorities grant concessions to private companies for waste management. The private sector is responsible for the collection, management, transportation, and disposal of the waste once it has obtained the concession.

WATER

The main infrastructure projects such as water dams, river diversions, wastewater and waterways are controlled by the Comisión Nacional del Agua (CONAGUA), a federal body under the supervision of the Ministry of Environment and Natural Resources (SEMARNAT). The construction and maintenance of such assets can be given to the private sector through concessions. For city distribution of water and waste-water (sewerage), each city has its own government body that is in charge of the administration, maintenance, and distribution to the end-user. However, there are few cities where water supply and sanitation services are provided by private companies through concessions.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in Mexico over and above existing regulation for investors and lenders more generally but a particular proposed investment may be subject to legislative or regulatory control (e.g., merger control rules) and/or foreign investment restrictions. As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be
considered, including environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body is
procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project
will be subject to central government approval. Key sector-specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and, in respect of
an existing/operational project, that will depend on whether there are any contractual restrictions on ‘change of control’. This is less of a
concern with private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be
affected by their acquisition of an interest.

Energy

Private investors can participate, alongside PEMEX and CFE, the two large state-owned enterprises, in a wide range of the energy industry
value chain, attracting capital and technology to areas that are in need of renewal. A cornerstone of the energy reform is the objective to
open the energy sector to private and international investment by ending the monopolies of state-affiliated enterprises.

The energy reform has opened five ways in which private investors can take part in the development of Mexico's oil and gas resources, in
all cases after pre-qualification and taking part in a bidding process conducted by the Comisión Nacional de Hidrocarburos (CNH), except
that service contracts can be agreed directly with PEMEX:

- License contracts allow a company to book ownership of oil or gas assets (for financial purposes) at the wellhead after it has paid its
tax dues, with the company paying a signing bonus, payments during exploration and royalties on production.
- Production-sharing contracts allow a company to recover costs and a share of the operating profit, received as a portion of the oil or
gas extracted.
- Profit-sharing contracts allow a company to recover costs and a share of the profit, after it has marketed and sold the resource.
- Under service contracts a company is paid for specified project activities on behalf of PEMEX or the state.
- Farm-outs/migrations allow a company to enter into a joint venture agreement with PEMEX in a project that has already seen
exploration and production efforts.

The public transmission and distribution of electric energy is still reserved to the state, provided by CFE and overseen by the new
regulatory body, the National Energy Control Centre (Centro Nacional de Control de Energía) (CENACE). CENACE is the operator of the
national electric system and wholesale market operator, however, CENACE can authorize private parties to participate in energy
distribution. To incentivize investment in renewables, the government has introduced clean energy certificates, a market instrument that
is part of broader power sector reform designed to support the share of electricity consumption to be generated from clean energy
sources. The revenue from the sale of certificates, which are purchased by producers and large electricity consumers, is intended to be
invested in other renewable energy projects.

Telecoms infrastructure

Foreign investment is authorized with no restriction for telecommunications and satellite communications and up to 49% for radio
broadcasting services.

The Federal Institute of Telecommunications (IFETEL) was created by virtue of the Telecommunications Reform as an independent
regulator with the authority, among other matters, to award and revoke concessions, guarantee economic competition in the
telecommunications and broadcasting markets, and determine the existence of ‘dominant carriers’ (participants with market participation
above 50% in both the broadcasting and telecommunications sector) to whom asymmetric regulation is to be applied (currently, America
Móvil in telecommunications and Televisa in broadcasting, have been deemed ‘dominant carriers’ by IFETEL).

Transport infrastructure

DOMESTIC PASSENGER, TOURISM AND FREIGHT TRANSPORTATION

Pursuant to the Foreign Investment Law, activities such as domestic passenger, tourism and freight transportation (except for messenger
or package delivery services) is restricted to Mexican individuals or Mexican companies without allowing foreign investment (a neutral
investment mechanism may be implemented to allow foreign investment where limited voting shares are issued to foreign investors).

AVIATION
Pursuant to the Foreign Investment Law, domestic air transportation services are subject to a foreign investment limit of 25%. The concessions and permits are granted pursuant to the Civil Aviation Law. Other foreign investment limitations apply.

SHIPPING

Pursuant to the Foreign Investment Law, national commercial freight shipping lines and port administration are activities subject to a foreign investment limit of 49% (a neutral investment mechanism may be implemented to allow foreign investment where limited voting shares are issued to foreign investors). Other foreign investment limitations apply.

RAIL

The Mexican government allows foreign investors to participate with up to 49% of the capital stock in companies providing railway service. Railroad activity with more than 49% foreign participation requires prior authorization from the Foreign Investment Commission.

Other infrastructure

On publicly procured infrastructure, it is quite common for long-term projects to have a 'change of control' clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the construction period but this is often relaxed post construction provided any change in control is not to an 'unsuitable third party'. How strict these restrictions are will often depend on the sector.

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What is the applicable procurement process?

Public procurement in Mexico is governed at a federal level by the Federal Law for Acquisitions, Leasing and Services for the Public Sector (Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público) and their corresponding laws in the different states and municipalities.

As part of the Energy Reform, CFE and Pemex have their own procurement regulations and the general law mentioned above does not apply to such governmental entities. The Ley de Petroleos Mexicanos and the corresponding procurement regulations issued by its Board of Directors are applicable to Pemex, and the Ley de la Comisión Federal de Electricidad and the corresponding procurement regulations issued by its Board of Directors are applicable to CFE.

Investing in energy and infrastructure

Public procurement is relevant where the Mexican government, or a branch of it, seeks to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation (as indicated above) applies to certain public bodies, such as federal government departments, and state and municipal authorities.

Public contracting may be carried out by any of the following:

- open bidding procedure (Licitación Pública);
- invitation to at least three participants; and
- direct adjudication.

The general rule for public contracting is to perform an open bidding procedure; however, applicable regulations expressly provide for exceptional cases under which the corresponding government bodies may observe a different procedure. There are three types of tender processes under federal regulations:

- National (reserved for Mexicans and Mexican products that contain at least 50% of its parts made in Mexico);
- International under international treaties (reserved for Mexicans and foreigners that are nationals from a country with which Mexico has a Free Trade Agreement and contains provisions for public procurement); and
- Open Internationally (open to Mexicans and foreigners irrespective of the origin of goods).
An investor may choose to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. However, such investments are controlled by contractual mechanisms within the original awarded contract rather than procurement regulations themselves and the parties are required to confirm whether legal thresholds under the Mexican Antitrust Law (Ley Federal de Competencia Económica) are exceeded, in which case the transaction would have to be notified to the Mexican Antitrust Commission (Comisión Federal de Competencia Económica) and obtain clearance before closing.

Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

In the case of public contracts financed from externally sourced credit granted to the federal government or guaranteed by regional or multilateral financial organizations, the procedures, requirements and other provisions for their contracting are established by the Ministry of the Civil Service (Secretaría de la Función Pública), with the opinion of the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público).

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Mexico (including in relation to Public-Private Partnerships) include the following.

Funding

- Loans made on a corporate finance basis (balance sheet debt)
- Loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders
- Bond finance
- Fibra E public offering (equity)
- Mezzanine debt (in some sectors)
- Refinancing of the debt in operational projects

Mexico's National Infrastructure Fund (Fondo Nacional de Infraestructura – FONADIN) has been a dynamic Mexican government tool to manage the development of national infrastructure in Mexico via public-private partnerships (PPPs), focusing on the highways, ports, airports, environment, urban mass transportation, water and tourism. FONADIN is one of the most important conduits for PPPs in Mexico by providing support – financing and know-how – for the planning, design, construction and final transfer of projects developed by the private sector. To be eligible for FONADIN support, projects must offer the country significant positive social impact and the prospect of major economic gain.

Investing

- ‘Equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans
- Secondary market investment in operational projects (acquisition of ‘equity’)

Restructuring

Enforcement and sanctions
When can there be regulatory investigations?

When the National Banking and Securities Commission (CNBV) or the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF), considers that an authorized firm or regulated individual may have breached ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

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What regulatory penalties may apply?

When a rule breach has taken place, the National Banking and Securities Commission (CNBV) or the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF) may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

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What criminal penalties may apply?

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Regulations; and
- conducting regulated activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There are no stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Most security interests must be registered at the Public Registry of Property and Commerce to ensure its validity against third parties. The fees payable for such registrations are generally not material in amount.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

There are no stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security.

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Do tax authorities take priority on enforcement?
On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g., secured bond holders)?

Secured lenders and secured debt security holders take priority over the Mexican Tax Authorities on enforcement of security.

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Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Yes, to the extent the interest is paid to a person who is not resident in Mexico. An expanded definition of interest applies for these purposes, which includes yields from all forms of credit, public debt, bonds or debentures. Interest payments between persons resident in Mexico are not subject to withholding taxes.

In addition, income deriving from the sale of a right to a receivable of any nature, whether present, future or contingent, by a person who is resident in Mexico to a person who is not resident in Mexico, is also taxed as interest. The amount of deemed interest income in the hands of the non-resident acquirer is determined as the difference between the nominal value of the receivable plus unpaid interest or returns that have not been subject to withholding tax, less the price paid on the sale. As such, the purchase of bad loans by a non-resident could be subject to withholding tax on the difference between the face value and the fair market value of the loans.

If so:

What is the rate of withholding?

The general Mexican withholding tax rate on interest paid to persons not resident in Mexico is 35% (with effect from 2014), unless an exception applies.

What are the key exemptions?

The following types of interest payments are exempt from Mexican withholding tax:

- interest paid on loans to the Mexican Federal Government;
- interest paid on loans with a term of three or more years granted by financial entities resident outside of Mexico and registered with the Mexican tax authorities that are dedicated to the promotion of exports by the provision of special-term loans (thus, for example, to the extent assets and equipment produced outside of Mexico can be financed by way of an export credit loan, Mexican withholding tax may be avoided on the interest payable on the loans);
- interest derived from certain financial debt derivative transactions involving the sale of federal government securities; and
- interest derived from the sale of monetary regulation bonds issued by the Bank of Mexico.

The withholding tax rate is reduced to the following percentages in the following cases:

- 4.9% – interest paid to a financial entity resident outside of Mexico in which the Mexican Federal Government has an equity participation through the Ministry of Finance (SHCP) or the Mexican Central Bank (Banco de Mexico), provided that the financial entity is the effective beneficiary of the payment and meets certain registration requirements;
- 10% – interest paid to an entity that invests or places capital in Mexico that is derived from securities that are issued outside of Mexico to, and placed outside of Mexico with, the general public;
- 10% – interest paid to a person not resident in Mexico that derives from the sale of a right to a receivable, or that is paid to a person not resident in Mexico on certain types of securities, provided specific requirements are met;
- 10% – interest paid to banks, investment banks and certain limited purpose financial companies, in each case, resident outside of Mexico, that are the effective beneficiaries of the interest (To qualify for the reduced rate, the institution concerned must provide information to the borrower to document its status as a qualified institution. It should be noted that the use of back-to-back loan
arrangements as a means of obtaining reduced withholding tax rates is not allowed under Mexican domestic law. The rate is reduced to 4.9% in the case of interest on loans paid to financial institutions resident in double tax treaty partner countries. The reduced rate of 4.9% is provided for through general regulations on an annual basis.

- 4.9% – interest paid on publicly traded securities or securities issued through a recognized stock exchange in a country with which Mexico has entered into a double tax treaty, where the securities are registered with the National Registry of Securities and Intermediaries, and certain information requirements are met (if the information requirements are not met or the securities are issued through an exchange in a country with which Mexico does not have a double tax treaty, the rate is 10%);

- 15% – interest paid to a lessor not resident in Mexico with respect to a finance lease (In this case, the interest is considered to be Mexican-source when the leased asset is used in Mexico, or when the payments made to the non-resident lessor are deductible in whole or in part by a permanent establishment in Mexico, even when the payments are made through an establishment located outside of Mexico); and

- 21% interest payments made by credit institutions to persons not resident in Mexico, other than registered banks;

- interest related to the sale on credit of machinery and equipment; and

- interest in connection with loans to finance the acquisition, installation and commercialization of fixed assets, provided the loan terms are documented in the contract and payment is made to an entity registered with the tax authorities for this purpose.

Furthermore, there could be reduced withholding tax rates available on interest payments to persons not resident in Mexico who are entitled to apply a double tax treaty concluded by Mexico.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes.

**Key contacts**

Edgar Romo  
Partner  
DLA Piper Gallastegui y Lozano  
edgar.romo@dlapiper.com  
T: +52 55 5261 1858
Morocco

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Under Moroccan law, there are certain restrictions on offering and selling debt securities.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Morocco unless an approved information document has been submitted for approval to the Moroccan regulator (AMMC).

The AMMC approves certain financial transactions before their execution and validates, depending on the case, the information document prepared in connection with the financial transaction. The AMMC has provided guidelines and circulars for the issuance of debt securities.

What are common issuing methods and types of debt securities?

Many issuing methods are used in Morocco and bond borrowing is one of them.

However, there are many types of debt securities in Morocco. The most frequently encountered are:

- Obligations;
- Certificates of deposit;
- Financing company bonds;
- Treasury bonds.

What are the differences between offering debt securities to institutional / professional or other investors?

There is a difference between qualified investors and other investors.

The AMMC provides for a list of qualified investors which are a legal entities with the skills and resources to necessary understand the risks inherent to transactions with financial instruments.

Are presumed qualified investors:


- banks;
- undertakings for collective investment in transferable securities;
- insurance and reinsurance undertakings;
- pension and retirement organizations;
- deposit and management fund;
- venture capital investment undertakings;
- undertakings for collective investment in securitisation, as governed by the legislation on the said bodies.

_When is it necessary to prepare a prospectus?_

Offerors wishing to complete a transaction on financial securities are required to prepare an information document which, before its public release, must, in most cases, be approved by the AMMC.

The information document must include all the information necessary for the public to make investors’ judgments about the issuer’s assets, financial position and business.

The information document must be updated as soon as new accounts are closed and new items arise. This update must also be validated by the AMMC.

_What are the main exchanges available?_

The organization, management and development of the stock market are granted to the Casablanca Stock Exchange (Bourse de Casablanca).

The Casablanca Stock Exchange manages the regulated markets of the Stock Exchange.

_Is there a private placement market?_

There is a private placement market in Morocco.

_Are there any other notable risks or issues around issuing or investing in debt securities?_

**Issuing debt securities**

Issuers are required to provide comprehensive information in relation to their financial situation and activities as well as to provide risk factors to bring the attention of investors. Issuers are accountable and liable for misleading or inaccurate information provided in their information document.

**Investing in debt securities**

Specific risks factors related to the securities and the ability of the issuer to repay the securities are generally provided for under the information document. An investor may lose all his investment in case of insolvency of the issuer.
Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

There are some restrictions regarding the establishment of a fund. Thus, legal structures adopted by investment funds belongs to one or the other of the following two categories:

- Venture capital investment funds that may take the form of Venture capital companies or Venture capital mutual funds;
- Conventional vehicles (public limited company (SA) or joint stock company (SAS)).

In addition, venture capital investment funds (organisme de placement en capital risque) (OPCR) and real estate investment funds (organisme de placement collectif en immobilier) de (OPCI) must be approved by the AMMC.

What are common fund structures?

In Morocco, investment funds belongs to one or the other of the following two categories:

Conventional vehicles

- Public Limited Company (SA);
- Joint Stock Company (SAS);
- Foreign companies (Limited Partnership, Limited Liability company and others);
- Limited partnership with shares (SCA).

Private equity: Venture Capital Investment funds (organisme de placement en capital risque) (OPCR)

- Venture Capital company (SCR);
- Venture Capital mutual funds (FCPR).

What are the differences between offering fund securities to professional / institutional or other investors?

The differences are more or less similar to the rules applicable to the offer of the securities.

Are there any other notable risks or issues around establishing and investing in funds?

Managing investments is a regulated activity under Moroccan law and there subject to AMMC authorization.

Managing and marketing debt / hedge funds
**Are there any restrictions on marketing a fund?**

The marketing of a fund’s products may be carried out by banks, management companies, brokerage firm or the deposit and management fund.

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**Are there any restrictions on managing a fund?**

An investment fund is managed by a management company, which is a commercial company that exclusively creates and manages investment products in compliance with regulatory and legal constraints and internally defined investment policies in order to obtain the best performance from it.

*Last modified 6 Jan 2020*

**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

There is no specific restrictions on entering into derivatives contracts. However, general restrictions could significantly affect to enter into derivatives such as the applicable currencies, the bankruptcy regulations or the exchange control rules.

*Last modified 6 Jan 2020*

**What are common types of derivatives?**

Bank Al Maghrib Directive concerning the risk management framework for derivatives products defines derivatives as follows: "A derivative is a financial contract whose value depends on that of an underlying asset or index".

It also specifies that "derivative transactions include interest rate contracts, foreign exchange contracts, property title contracts, commodity contracts and options contracts".

The most common derivatives used to hedge interest rate risk are as follows:

- Cap, floors, collars;
- Swaps;
- Options;
- Futures;
- Forwards.

*Last modified 6 Jan 2020*

**Are there any other notable risks or issues around entering into derivatives contracts?**

It should be mentioned the application of the general instruction of foreign exchange applicable to forward financial instruments.

*Last modified 6 Jan 2020*

**Debt finance**

**Lending and borrowing**
Are there any restrictions on lending and borrowing?

Lending

The execution of usual credit transactions requires that the institution concerned has been authorised under the terms of an authorization issued by Bank-Al-Maghrib.

Once authorization has been obtained, any bank wishing to carry out credit operations must comply with a certain number of rules and obligations, both internally, in particular by complying with prudential ratios, and with regard to its client, in particular by exercising a duty of vigilance.

Borrowing

Borrowing is generally not regulated.

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What are common lending structures?

There is no mandatory lending structure in Morocco, lending can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Loans will be structured to achieve specific objectives, e.g. term loans, working capital loans, equity bridge facilities, project facilities assets financing, etc.

Loan durations

The duration of a loan can vary depending on the parties willingness:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues.

Loan security

A loan can either be secured, unsecured or guaranteed.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or in full on the maturity date.

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What are the differences between lending to institutional/professional or other
**borrowers?**

There are specific provisions concerning external financing operations:

These are external loans granted to Moroccan legal entities registered in the Commercial Register or to branches of foreign companies, registered with the Exchange Office. In this context, a number of documents must be submitted to the bank before the execution of the regulations on the reimbursement of external loan maturities, and declarations must be made to the exchange office.

Finally, there are specific provisions applicable to loans granted to non-residents:

**Financing in Dirhams**

These are the following loans granted to non-residents:

- Loans in Dirhams granted by banks to non-resident foreign individuals and Moroccans residing abroad, intended to finance the acquisition and/or construction of real estate in Morocco;

- Consumer credits granted in Dirhams by banks to foreign personnel working for diplomatic missions accredited in Morocco or international organizations based or represented in Morocco;

- Credit lines and facilities granted to branches registered with the Exchange Office in connection with the execution of contracts in Morocco, which the remuneration is denominated entirely in Moroccan Dirhams.

**Commercial credits**

These are credits granted by the exporter of goods or services, or a Moroccan bank alone or as part of a consortium in favour of non-resident customers, in the form of supplier credits or buyer credits repayable in the short or medium term.

**Do the laws recognize the principles of agency and trusts?**

**Agency (mandat)**

Agency exists under Moroccan law.

**Trust and fiducie**

Neither trust agreement nor *fiducie* has been recognized by the Moroccan jurisdictions.

**Are there any other notable risks or issues around lending?**

There is a general requirement to use MAD for domestic transactions but if another currency is used, an office exchange approval may be needed.

Credit institutions are subject to a general regime for information, advice and warnings in their relations with their customers.

Credit institutions are required to provide more specific information on people with consumer status.

Moroccan borrowers (professionals or consumers) must receive an information from the lenders on the percentage rate of charge (*taux effectif global*) of any credit transaction governed or not by Moroccan Law.

**Are there any other notable risks or issues around borrowing?**
Bank Al-Maghrib regularly issues advisory circulars and directives on various subjects (prudential provisions, overall effective rate).

Financial institutions, as part of their borrowing policy, must comply with the above-mentioned texts.

Moreover, borrowing must be part of the corporate object and of the corporate interest of the borrower.

**Giving and taking guarantees and security**

*Are there any restrictions on giving and taking guarantees and security?*

**Capacity**

The creation of a guarantee or security by a company implies that the latter has the ability to act on it, regarding its corporate documents and provisions applicable under Moroccan law.

In particular, the following conditions must be met:

- the act must fall within the company's corporate purpose;
- the act must not be contrary to the social interest of the company;
- authorization given by the competent corporate bodies of the company to conclude the act;
- power of the signatory;
- where applicable, compliance with the regime of regulated agreements.

**Insolvency**

The court could cancel any provision of a guarantee or security when it is made by the debtor after the date on which payments are suspended.

**Financial assistance**

The principle of prohibition of financial assistance is the prohibition on a company financing or guaranteeing the purchase of its own shares.

**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees can take a number of forms, the more common ones being:

- a corporate guarantee (*cautionnement*), which is an undertaking taken by a guarantor towards a beneficiary to pay a debtor's debt in case of non-payment by the latter (such guarantee is ancillary to the principal obligation – the obligations of the guarantor are closely linked to the obligations of the main debtor);

- an autonomous guarantee (*garantie autonome*), which is an undertaking taken by a guarantor, in light of a third party's obligation, to pay a sum of money to a beneficiary on first demand or upon the terms and conditions agreed between the parties (it is a non-ancillary separate and distinct obligation – the guarantor may not raise any exception pertaining to the obligation of the debtor and, unless otherwise agreed between the parties, such guarantee does not follow the guaranteed obligation); and

- a letter of intent (*lettre d'intention, lettre de confort or lettre de patronage*), which is an undertaking to do or not to do, so as to support a debtor in the performance of its obligation towards the creditor (its purpose is to ensure that the debtor will be in a position to satisfy its obligations - otherwise, the issuer of the letter will have to indemnify the creditor for any damages incurred because of such failure).
Common forms of security

MORTGAGES (HYPOTEQUES)

A mortgage is "an accessory real right relating to immovable property registered or in the process of being registered and used to guarantee the payment of a debt".

It may be conventional or forced and is subject to strict conditions for the constitution of the property and the rights that may be mortgaged, the grantor, the principle of speciality, form and publicity.

PLEDGE WITH DISPOSSESSION AND PLEDGE WITHOUT DISPOSSESSION

Moroccan law makes a distinction between the pledge with dispossession which requires the dispossession of the pledged asset (gage) and the pledge without dispossession which does not require such dispossession (nantissement).

There are several types of security interest that are suitable for securing different types of assets such as receivables, bank accounts and securities accounts.

A national electronic register of pledges has been created by the law 21-18 dated 22 April 2019 which should be functional at the beginning of 2020 and administrated by the Ministry of the Economy and Finance.

ASSIGNMENT OF TRADE RECEIVABLES

The Moroccan legislator was inspired by the Dailly assignment under French law to establish the legal framework for the assignment of professional receivables.

Moroccan law defines the transfer as "the delivery, by way of a slip to a banking institution, of the claim held on a third party, a natural person in the exercise of its activity, or a legal person governed by private or public law".

Are there any other notable risks or issues around giving and taking guarantees and security?

The main points that should be checked are as follows.

Risks issued from the reform of security over movable assets and the planned establishment of the national electronic pledge register

Vigilance is needed to the substantive and formal requirements applicable to each guarantee and security to be granted, in particular following the reform of security over movable assets and the planned establishment of the national electronic pledge register.

Some guarantees and securities require, for example, mandatory statements of the validity of the act. This is the case, for example, for the transfer of trade receivables, which requires the insertion of information listed in Moroccan law.

Regarding the pledge without dispossession, a distinction should be made between the scheme before the establishment of the national electronic register and the subsequent scheme. The latter should be launched at the beginning of 2020.

Prior to the establishment of the said register, the pledge must be registered and filed with the clerk's office of the competent commercial court, which will keep an extract from the act making it enforceable against third parties.

Subsequent to the establishment of the register, the pledge must be entered in the said register and notified to the bank holding the debtor's account.

Specific rules applicable to guarantees granted by companies

The Moroccan Law 78-12 provides for rules applicable to certain guarantees granted by companies. For instance, it is not possible for some companies to guarantee the obligations of managers and shareholders and/or directors. Specific advice should be sought...
depending on the form of company.

Handwritten wording to be inserted in a corporate guarantee (cautionnement)

In a guarantee granted by a private deed, it is required that the guarantor write by hand the amount of the secured obligations in words and figures.

Specific rules applicable to corporate guarantee (cautionnement) granted by individuals

The Moroccan Law 31-08 provides for specific rules applicable to corporate guarantees granted by individuals. In particular, the guarantors' undertaking shall be proportionate to its revenues and assets at the time when the guarantee is granted, except if the guarantor's assets are sufficient to satisfy its obligations when the guarantee is called.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

- The Dahir of 12 August 1913 establishing the Code of Obligations and Contracts;
- The Dahir No. 1-96-83 of 1 August 1996 promulgating Law No. 15-95 which establishes the Commercial Code;
- The Dahir No. 1-11-03 of 18 February 2011 promulgating Law No. 31-08 which provides consumer protection measures;
- The Dahir No. 1-14-193 of December 24, 2014 promulgating Law No. 103-12 on credit institutions and similar bodies;
- The circulars and directives of Bank Al-Maghrib (BAM) and the Moroccan capital market authority (Autorité marocaine du marché des capitaux/AMMC);
- The Law No. 18-95 establishing the investment charter (charte de l'investissement).

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Regulatory authorization

Who are the regulators?

Morocco has two (2) main regulators:

- Bank Al-Maghrib (BAM) which ensures the proper functioning of the banking system and ensures the application of the laws and regulations relating to the exercise and control of the activity of credit institutions and similar bodies;
- L'Autorité Marocaine du Marché des Capitaux/AMMC (Moroccan capital market authority) whose main objective is to ensure effective market and stakeholder supervision and, more generally, to support the market development process.

In addition of these two regulators, there is the Comité des Etablissements de Crédits (the credit institutions committee), which carries out all studies relating to the activity of credit institutions, in particular, their relations with customers and public information. This committee is chaired by the Wali (Governor) of Bank Al-Maghrib.

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What are the authorization requirements and process?
The exercise of banking activity is subject to obtaining an authorization issued by the Wali (Governor) of Bank-Al Maghrib after consulting the Credit Institutions Committee.

Banking activities in Morocco must be carried out in accordance with the legal requirements relating to legal form, share capital or assets and liabilities.

The regulators assess whether the application meets the required conditions such as:

- the nature of the approval requested;
- the capital providers, the home group and the shareholders of the institution seeking approval;
- the legal documentation and governance of the said institution;
- the presentation of the project, its objectives, its implementation schedule, the related business plan and the human, technical and financial resources necessary for its implementation;
- internal control, risk management, anti-money laundering and anti-terrorist financing and personal data protection systems;
- the approval file of the auditors whose appointment is being considered;
- in the event of affiliation with a financial institution, the supervision exercised by the said institution and the prudential supervision to which it is subject;
- the opinion of the home country supervisory authority where the applicant institution is a foreign financial institution.

What are the main ongoing compliance requirements?

The compliance requirements are:

- compliance with the legal form of institutions carrying out banking activities;
- compliance with legal and economic conditions (minimum share capital, compliance of an asset/liability ratio, condition of good reputation of directors, competence, etc.).

What are the penalties for failure to be authorized?

Criminal sanctions applicable to individuals carrying out a regulated activity without authorization:

- imprisonment from 3 months to 1 years and/or a fine of MAD20,000 to MAD200,000 for any person improperly using a trade name, a company name or an advertisement and, in general, any expression suggesting that he is authorized as a credit institution;
- imprisonment from 6 months to 3 years and/or a fine of MAD100,000 to MAD5 million for any person who carries out operations for which he has not been approved;
- the court may also order the closing of the establishment where the offence was committed and the publication of the judgment in the newspapers it designates at the convicted person's expense.

Criminal sanction applicable to legal entities provided by the Law for failure to be authorized is the closing of the entity where the offence was committed.

Regulated activities

What finance and investment activities require authorization?
Activities requiring authorization include:

- receiving funds from the public;
- credit transactions;
- issuing means of payment to customers and their management;
- foreign exchange transactions;
- transactions on gold, precious metals and coins;
- life and health insurance, assistance, credit insurance and any other insurance transactions;
- leasing of movable or immovable property;
- investment services (including, in particular, the management of financial instruments, trading of financial instruments on own account or on behalf of third parties or the receipt and transmission of orders on behalf of third parties).

*Are there any possible exemptions?*

Moroccan law provides exemption from licensing for certain limited transactions.

Thus, any person can perform the following operations:

- grant its contractors, in the exercise of its professional activity, payment deadlines or advances, in particular in the form of commercial credit;
- conclude lease with option to purchase contracts for housing;
- carry out treasury transactions with companies that have, directly or indirectly, capital ties with it and giving to one of them effective control over the other companies;
- issue securities and debt securities negotiable on a regulated market;
- grant advance on salaries or loans to its employees for social reasons;
- issue vouchers and cards issued for the purchase of specified goods or services from it;
- take or repurchase securities listed on the stock exchange, negotiable debt securities or securities issued by the public treasury;
- provide cash as a guarantee of securities lending transactions.

*Do any exchange controls or other restrictions on payments apply?*

In Morocco there is a foreign exchange regulation implemented by the foreign exchange office. The foreign exchange office is a public authority under the supervision of the Ministry of Finance. Investment and funding made outside Morocco are subject to prior approval of the foreign exchange office. Investment and funding made to Africa are encouraged by the office.

Moroccan residents are entitled to an annual tourist allowance in foreign currency of the equivalent of MAD20,000 per trip up to a maximum of MAD45,000 per calendar year.

The tourist allowance that will be issued, for travel, by a bank, exchange office or money transfer intermediation company duly authorised to carry out manual exchange, must be used within 60 days from the issue or returned to the bank counters in the event of non-use.

*What are the rules around financial promotions?*
Moroccan law defines the concepts as well as the persons authorized to carry out financial solicitation (démarchage).

A financial solicitation occurs when a person in contacted without having requested it, by any means whatsoever (mail, phone etc.), to offer a potential transaction on financial instruments.

Only financial intermediaries and natural legal persons authorised by the financial intermediaries are authorised to carry out financial solicitation.

**Entity establishment**

*What types of legal entity are generally used to undertake financial or investment activity?*

Banking institutions headquartered in Morocco must have the legal status of a fixed-capital public limited company or of a cooperative company with floating capital.

**Is it possible to conduct lending or investment business through a branch or establishment?**

Credit institutions headquartered abroad may apply for the establishment of a subsidiary or the opening of branch in Morocco.

**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Crowdfunding**

The law on collaborative financing or crowdfunding was adopted by the Government of Morocco to regulate the activity of electronic collaborative funding platform (plateforme électronique de financement collaborative, or PFC). This law created the status of the collaborative funding company (société de financement collaboratif, or SFC) to manage PFCs and defined a system for the accreditation of SFC and for the supervision and monitoring of collaborative financing. The law also defines the SFC commitments and obligations, in particular with regard to public information, advertising and reporting.

**Blockchain, smart contracts and cryptocurrencies**

In 2017, the foreign exchange office in Morocco initially banned the use of crypto currencies sending a negative signal to the players of the Blockchain industry.

Then, the Governor of Bank Al Maghrib caused a turnaround by integrating the Blockchain and cryptos currencies into the digitalization charter of the 2019- strategic plan 2023 of Bank Al Maghríb.

This unblocking has enabled Blockchain operations to be set up in Morocco, although adequate regulation and the creation of tools to ensure the security of the value chain are still expected.
In particular, the Kingdom of Morocco has created a Digital Development Agency (ADD) in charge of promoting and developing new technologies.

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**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

Bank Al-Maghrib and the Moroccan Capital Market Authority (AMMC) are the main entities that supervise and regulate companies that provide banking and financial products and services.

It is prohibited to carry out a regulated activity in Morocco without a permit or exemption. A banking or financial activity is subject to authorization when it is identified as a regulated activity. As far as Fintechs are concerned, this is still a new concept in the Moroccan legal sphere. Strictly speaking, there are no specific regulations prohibiting or authorizing a particular type of FinTech activity.

However, the creation and operation of a high-tech company must be analysed on a case-by-case basis, taking into account existing laws and regulations applicable to banking, finance and insurance.

Financial regulators and legislators in Morocco have nevertheless been receptive to innovation in the field of information technology. For example, Moroccan law introduces the concept of participatory banking and Islamic banking for its contribution to the Fintechs.

It also introduces the concept of payment institution and agent of payment. In addition, the same company recognizes its electronic currency.

**Electronic payment platforms and regulation of peer-to-peer lenders**

**ELECTRONIC PAYMENT PLATFORMS**

Electronic payment platforms are considered as regulated payment service activities, offered by payment institutions and requiring an authorisation from Bank Al-Maghrib in accordance with Moroccan law.

**REGULATION OF PEER-TO-PEER LENDERS**

The exercise of a regulated banking activity is considered as such if the company in question provides or facilitates loans and borrowings between individuals or between individuals and companies, through an electronic platform. Such activity may be carried out if the company is authorised as a credit institution, financing company or payment institution.

**REGULATION OF PAYMENT SERVICES**

When a company provides payment services as part of a regular activity in Morocco, it must be approved in advance by Bank Al-Maghrib. The provision of such services without authorization is a criminal offence.

**MONEY LAUNDERING REGULATIONS**

Moroccan law provides the regulations applicable to this type of offence.

In addition, the Anti-Money Laundering Act designates Bank Al-Maghrib as the authority responsible for controlling and supervising taxable persons within its field of competence.

In this respect, it is responsible, with regard to these persons subject to tax, for:

- Ensure that taxable persons comply with the provisions of the Law anti-money laundering;
- Establish the procedures for implementing the provisions of the said law (relating to the obligation of supervision and the obligation of internal monitoring).

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

THE INITIAL INVESTMENT

Investment in FinTech companies can be made by the family and friends of the founders and other wealthy individuals (investors) in exchange for an equity stake. These investments are used to finance the company and grow the company's initial investment before more significant investments are available.

The people who invest can also bring their know-how and expertise to contribute to the development of the company.

CROWDFUNDING

Crowdfunding can be appropriate for a FinTech start-up company. It is the investment by individuals, in a company, through an intermediary platform.

VENTURE CAPITAL AND DEBT

Private equity is a financial activity that consists of a professional investor entering, for a fixed period of time, into the capital of companies, not listed on the stock market, requiring equity capital. Venture capital is one component of this.

It can finance start-up, growth, transmission or recapitalization in the event of difficulties.

It is an alternative source of financing available to companies facing the constraints and limits imposed by traditional sources of financing such as equity, bank financing and public offerings.

Venture capital financing is a type of equity investment that typically targets early-stage FinTech companies with an established business and business history. Venture capital is a viable alternative to traditional loans because it is unlikely that the company has the tangible assets or long history necessary to attract traditional debt financing from financial institutions.

Investors provide equity or quasi-equity financing to companies in the creation or start-up phase of their business.

Depending on the maturity of the project to be financed, venture capital is subdivided as follows:

- the creation finances the start-up of the company's activity;
- post-creation occurs when the company has already completed the development of a product and needs capital to start production and marketing.

SENIOR BANK DEBT

Once a FinTech company is established and proven, bank debt becomes a more viable source of financing, whether secured or unsecured, depending on the company's creditworthiness and assets. Unlike financing in financial markets, which often includes restrictive covenants, bank financing generally involves the imposition of restrictive covenants and financial controls that will apply throughout the duration of the facility.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Assignment of receivables / assignment of contract
The assignment of a receivable as well as the assignment of a contract brings together three persons: the original creditor (the assignor), the new creditor (assignee) and the debtor, who does not change.

The debtor will have to pay his debt to the assignee and no longer to his original creditor.

Subrogation

Subrogation, which may be conventional or legal, is governed by Moroccan law. This is an amendment to the legal relationship consisting in substituting one person for another.

Novation

Novation constitutes a mechanism for the extinction of an obligation by the creation of a new obligation in substitution. In other words, novation is a contractual effect which, either not as a result of the change of creditor or as a result of the change of debtor, modifies the conditions for the performance of a contract.

What are the main considerations when transferring a loan and related security?

The main considerations to be taken into account when transferring a loan are as follows:

- the consent of the parties;
- eligibility of the lender;
- formalities of enforcement;
- confidentiality;
- protection of personal data;
- banking monopoly.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Energy and power

Regarding electrical energy, it is the National Electricity Office (ONE), a public body with industrial and commercial functions, which is responsible in particular for producing and managing electricity. Subject to prior approval by the ONE and eligibility of the project, private companies may create and operate means of electricity generation. Electricity transmission is also operated by the ONE.

Regarding energy production infrastructure (hydroelectricity, renewable energy, wind power, etc.), it is owned by the private companies in charge of the various projects.

Oil and gas

Morocco’s National Office of Hydrocarbons and Mines (Office national des hydrocarbures et des mines i.e. ONHYM) was created on 17 August 2005 to contribute to economic development by developing Morocco’s natural oil and mining resources (excluding phosphates).

Regarding Gas distribution, this activity is carried out by private companies such as Afriquia or Akwa Group.
Telecommunications sector

A majority of the telecommunications networks are owned by private companies (Maroc télécom, Orange, Inwi). Nevertheless, the State remains, in part, the owner of part of the capital of certain companies.

The telecommunications sector is regulated and managed by the National Telecommunications Regulatory Agency (ANRT), which is a Moroccan public body.

Transport infrastructures

THE RAILWAY NETWORK

Rail infrastructures are owned by the National Railway Agency (ONCF). The ONCF is responsible for operating the country's rail network and is a public body with industrial and commercial functions. It is financially independent and placed under the supervision of the Ministry of Equipment and Transport.

HIGHWAYS

The Moroccan highway network is owned to a very large extent by the Moroccan State through the Moroccan Highways National Company (ADM), which is a public limited company with public capital.

ADM’s capital is mainly held by the public purse and the Hassan II fund. A tiny part of the capital is held by private institutions.

AVIATION

The airports are managed by the National Office of Airports (ONDA).

The aviation sector is regulated by the Directorate-General for Civil Aviation.

Other infrastructures

Social infrastructure (schools, hospitals, jails, etc.) is owned in some cases by the State.

Are there special rules for investing in energy and infrastructure?

There are no specific regulations applicable to investments in energy and infrastructure in Morocco, subject to antitrust clearance.

The State also encourages investors to invest in the energy sector.

Depending on the projects under consideration, prior authorisation from the relevant authorities should be obtained.

What is the applicable procurement process?

The public procurement is based on constitutional principles:

- Freedom of access to public procurement;
- Competitive bidding of candidates;
- Guarantee of competitors' rights;
- Equal treatment of competitors;
- Transparency in the choice of the project owner.

These principles imply the respect of some basic rules:
• Preliminary definition of needs;
• Compliance with disclosure obligations;
• Call for competition;
• Choice of the most advantageous offer.

Public procurement must:

• Obey principles and rules laid down by the regulations in force;
• Be carried out in accordance with the conditions and forms.

Under Moroccan law, three procedures limit competition:

• Restricted tender process;
• Negotiated contracts;
• Services on purchase orders.

This decree also allows public purchasers to use certain procedures known as exceptional procedures under the competition rule in very specific cases under the regulations in force, and this:

• to deal with certain cases of force majeure;
• to take into account the specificities of certain departments, but also of certain services;
• as a facility for management services.

What are the most common forms of funding / investing in energy and infrastructure?

The different forms of funding/investing in Morocco are mainly:

Loan

The bank loan deals with all types of projects. However, it is necessary to provide a minimum amount of equity capital and to bear a certain level of risk. To grant loans, banks often require the personal guarantee of the project owner, who must, for example, accept a mortgage on his home or the pledge of his movable property.

Investment capital

This type of investment can be made at different stages of the company’s development cycle. In most cases, investment funds are specialized according to the development phase in which they operate:

• Venture capital or seed capital for investments in start-ups;
• Growth capital for investments in developing companies, with at least 3 to 5 years of activity. The equity investment generally takes the form of a capital increase and is intended to help the company financing ambitious growth projects;
• Transmission capital for investments in mature companies with stable growth, and corresponds to the sale of shareholders (usually creators) of their shares in the company.

Restructuring

Enforcement and sanctions
**When can there be regulatory investigations?**

Bank Al Maghrib is responsible for (i) monitoring credit institutions’ compliance with the legal provisions applicable to them, (ii) verifying the adequacy of the administrative and accounting organisation and the internal control system of those institutions and (iii) to ensure the quality of their financial situation.

In the course of its duties, BAM is authorized to carry out on-the-spot and documentary inspections of the above-mentioned establishments by its agents or by any person commissioned for this purpose by the Governor.

In addition, BAM may ask the bodies under its control to communication of all documents and information necessary to the performance of its control mission.

*Last modified 6 Jan 2020*

**What regulatory penalties may apply?**

In the event of a breach of the legal provisions, there are disciplinary sanctions (financial penalty, warning, warning or injunction) or criminal sanctions such as a fine or imprisonment or the closure of institutions.

*Last modified 6 Jan 2020*

**What criminal penalties may apply?**

The criminal sanctions that may apply to credit institutions and their employees are listed under Moroccan law.

These include, in particular:

- imprisonment of up to three (3) years;
- fine of up to MAD2 million;
- closure of the establishment where the offence was committed;
- publication of the judgment in the newspapers designated by the court at the convicted person’s expense.

*Last modified 6 Jan 2020*

**Tax**

**Tax issues**

**Are stamp, registration, transfer or other similar taxes applicable?**

Moroccan law provides that acts and agreements drawn up in Morocco, acts and agreements concluded in a foreign country relating to property, rights or transactions whose base is located in Morocco and all other acts and agreements concluded outside Morocco and producing their legal effects in Morocco are subject to registration formalities.

Moreover, stamp duties, in whatever form, shall be imposed on all acts, documents, books, registers or records drawn up in order to constitute the title to or justification of a right, obligation, or discharge and, in general, to establish a legal fact or legal relationship.

It should be noted that the Moroccan law exempts acts recording credit transactions between individuals and credit institutions and similar bodies as well as real estate credit transactions concluded between individuals and finance companies are exempt from registration and stamp duties.

*Last modified 6 Jan 2020*
**Do tax authorities take priority on enforcement?**

The Treasury has a general lien on moveable properties and other personal effects belonging to taxpayers wherever they are located. Therefore, when the tax has not been paid on the due date and in the absence of a claim with a request for suspension of payment, the Treasury accountant must send the taxpayer a letter of formal notice at least 20 days before the first act of prosecution is notified.

Last modified 6 Jan 2020

**Is withholding tax on interest payments applicable?**

Credit institutions and similar bodies are permanently exempt from withholding tax on interest and other similar income.

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**Are foreign lenders and debt security holders subject to tax on interest payments?**

No.

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**Key contacts**

**Fabrice Armand**  
Partner  
DLA Piper Casablanca s.a.r.l.  
fabrice.armand@dlapiper.com  
T: +212 520 427 856
Netherlands

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Yes.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in the Netherlands or to request that they be admitted to trading on a regulated market operating in the Netherlands unless an approved prospectus has been made available to the public.

The Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) has published additional guidelines on issuing debt securities to the public in the Netherlands and/or their admission to trading on a regulated market operating in the Netherlands.

Last modified 6 Dec 2019

What are common issuing methods and types of debt securities?

Customarily the issuing entity itself will issue debt securities in the form of bonds which can take any of a number of forms.

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What are the differences between offering debt securities to institutional/professional or other investors?

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in the Netherlands or to request that they be admitted to trading on a regulated market operating in the Netherlands unless an approved prospectus has been made available to the public.

Some exclusions and exemptions that could apply and relate to the type of investors are that no prospectus will need to be made publicly available for the offer of debt securities to the public in the Netherlands in the event that:

- the securities are offered exclusively to qualified investors;
- the securities are offered to fewer than 150 persons, other than qualified investors;
- the securities on offer can only be acquired for an equivalent value of at least €100,000 per investor; or
- the denomination per security is at least €100,000.

Last modified 6 Dec 2019
**When is it necessary to prepare a prospectus?**

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in the Netherlands or to request that they be admitted to trading on a regulated market operating in the Netherlands unless an approved prospectus has been made available to the public.

Below, the most relevant exclusions and exemptions are discussed.

No prospectus will need to be made publicly available for the offer of debt securities to the public in the Netherlands in the event that:

- the securities are offered exclusively to qualified investors;
- the securities are offered to fewer than 150 persons, other than qualified investors;
- the securities on offer can only be acquired for an equivalent value of at least EUR100,000 per investor;
- the denomination per security is at least EUR100,000; or
- the offer of securities to the public have a total consideration in the European Union of less than EUR 1,000,000 calculated over a period of 12 months.

Lastly, no prospectus will need to be made publicly available for offering debt securities to the public in the Netherlands or requesting that the debt securities will be admitted to trading on a regulated market operating in the Netherlands, if:

- the debt securities have a total consideration in the EU of less than EUR 5 million - this threshold is lower than the EUR 8 million maximum threshold possible under the Prospectus Regulation. For offers below EUR 5 million, the issuer in the Netherlands must: (i) notify the Dutch Authority for the Financial Markets (Autoriteit Financieele Markten, AFM) of the offering of securities to the public; and (ii) complete an information document in the form required under Dutch law, submit the completed form to the AFM and make the information document available to investors;
- it concerns a very specific type of securities.

*Last modified 6 Dec 2019*

**What are the main exchanges available?**

Currently, the following exchanges are authorized to operate as a regulated market in the Netherlands:

- Euronext N.V.;
- Euronext Amsterdam N.V.;
- ICE ENDEX; and
- Nxchange.

Furthermore, TOM B.V. is authorized as a multilateral trading facility in the Netherlands.

*Last modified 6 Dec 2019*

**Is there a private placement market?**

Yes.

*Last modified 6 Dec 2019*

**Are there any other notable risks or issues around issuing or investing in debt securities?**
There are no specific risks under Dutch law (other than regulatory considerations and general doctrines).

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document and oral statements concerning the issue of the offering document or the content of the offering document can give rise to both civil and criminal liability under Dutch law. The requirements are specified in case law on this subject. The Netherlands furthermore has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum.

Investing in debt securities

There are no specific Dutch law related risks or issues in relation to the issue of debt securities.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Undertakings for Collective Investment in Transferable Securities (UCITS)

According to Dutch law, no party may offer units in UCITS in the Netherlands:

- unless the management company of the UCITS has been licensed by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) to manage UCITS or is otherwise exempt from this license obligation; or
- in the case of a company for collective investments in securities without a separate management company, if the company for collective investments has not been licensed by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) or is otherwise exempt from this license obligation.

Alternative Investment Funds

According to Dutch law, no party may offer units in a collective investment scheme in the Netherlands:

- unless the management company of the collective investment scheme has been licensed by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) to manage collective investment schemes or is otherwise exempt from this license obligation; or
- in the case of a collective investment company without a separate management company, if the investment company has not been licensed by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) or is otherwise exempt from this license obligation.

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What are common fund structures?

Common forms of funds include:

- open-ended and closed-ended funds;
- retail and non-retail funds (including Alternative Investment Funds (AIFs));
- Undertakings for Collective Investments in Transferrable Securities (UCITS) and non-UCITS funds; and
- qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

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What are the differences between offering fund securities to professional / institutional or other investors?

Licensed fund vehicles/managers in the Netherlands may offer units to both retail investors and professional investors. Depending of the type of investor being dealt with (ie professional/institutional versus retail), different information provision requirements will be applicable. Higher levels of protection apply when offering units in fund vehicles to retail investors.

Last modified 6 Dec 2019

Are there any other notable risks or issues around establishing and investing in funds?

There are no specific risks to highlight here, other than the general regulatory framework that applies.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Yes.

Funds may only be marketed in the Netherlands once an authorization has been obtained. Furthermore, certain detailed marketing requirements may apply if marketing is targeted at retail investors (eg restrictions in relation to cold calling).

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Are there any restrictions on managing a fund?

Yes.

Funds may only be managed after having obtained the relevant authorization.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

The European Market Infrastructure Regulation applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

Furthermore, as derivatives qualify as financial instruments, restrictions under the Markets in Financial Instruments Directive (2014/65/EU) as implemented in the Dutch Financial Supervision Act (Wet op het Financieel Toezicht) may apply (eg requirements that are applicable on the provision of investment services).

Furthermore, please note that in the Netherlands it is not usual to enter into a derivative contract with a non-professional party as this would be considered high risk.

Last modified 6 Dec 2019

What are common types of derivatives?
The following derivatives are common types in the Netherlands:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps);
- options (call options and put options); and
- warrants.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007 to 2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

The following lending activities require, in principle, authorization:

- providing banking activities, including lending;
- offering, directly or indirectly, credit to a consumer and managing or performing a credit agreement with a consumer;
- performing advisory services to a consumer in relation to credit;
- providing brokerage services to a consumer in relation to credit; and
- crowdfunding activities.

Borrowing

The following borrowing activities require, in principle, authorization:

- providing banking activities, including borrowing;
- crowdfunding activities; and
- attracting, obtaining or having the disposal of 'callable funds'.

Callable funds is a term used by the Dutch legislator that includes deposits and other repayable funds as entailed in the definition of a
What are common lending structures?

In acquisition finance transactions, the most common lending structure is one by means of which funds are lent to a parent (holding company) or acquisition company which then uses the proceeds of the funds lent (together with an equity contribution (which can be structured as a debt instrument as well), to acquire the relevant target concerned. Senior/mezzanine structures are not commonplace any more (the most dominant structure is currently a senior only structure). Direct lending and unitranche structures now also play a major part in the lending landscape in the Netherlands. The equity/debt mix is currently around 40/60 to 50/50.

Real estate finance transactions usually entail an opco/propco structure, whereas other forms of financing structure customarily entail lending directly to the relevant borrowing entity.

Loan durations

Senior financing customarily has a duration of five to seven years with mezzanine maturity dates being at least six months longer than the senior financing.

Loan security

Loan documentation usually contains a joint and several liability structure for all obligors. Security extends to receivables, moveable assets, shares, intellectual property and real estate.

Loan commitment

Committed loans are customary in the Netherlands.

Loan repayment

Repayment of loans can take any of a number of forms, the most common being amortizing (for A Facilities) and bullet (for B Facilities). The Loan market for repayment generally follows the Loan Market Association standard.

What are the differences between lending to institutional / professional or other borrowers?

The following financial services only need authorization in the event that the service is provided to a consumer:

- offering, directly or indirectly, credit to a consumer and managing or performing a credit agreement with a consumer;
- providing advisory services to a consumer in relation to credit; and
- providing brokerage services to a consumer in relation to credit.

Therefore, if these services are solely provided to institutional or professional (ie non-consumer) borrowers, the services are not regulated under the Financial Supervision Act (Wet op het financieel toezicht). However, in the event that a financial entity has obtained an authorization, various rules will be applicable to this financial entity (eg rules concerning its governance structure, conduct of business and operational management).

A bank (ie a credit institution) will need authorization in the event that banking services are provided to consumers and/or
non-consumers. The rules that are applicable to banks (eg rules concerning their governance structure, conduct of business, operational management, proper service providing and financial health of the company) are applicable to all activities that the bank performs, including lending to consumers and non-consumers. However, the more professional the client of the bank is, the less far-reaching the rules concerning proper service providing are (eg the more professional, the less (pre-) contractual information duties will be applicable to the bank).

Furthermore, based on Dutch civil law, a (special) duty of care is applicable to financial entities, including banks. This (special) duty of care requires that banks should, in all their activities, take the interest of their clients (consumers and non-consumers) into account. The more professional the client of the bank is, the less far-reaching the (special) duty of care of the bank towards its client will be.

Please note that this concept is developed in Dutch legal precedents and that it is subject to continuous change. The (special) duty of care that a bank might have, is highly dependent on the specific circumstances of the case.

In conclusion, lending to institutional/professional borrowers is subject to less regulatory oversight and so is less burdensome from a compliance perspective.

Last modified 6 Dec 2019

**Do the laws recognize the principles of agency and trusts?**

The principle of agency is recognized under Dutch law.

Although a trust cannot be created under Dutch law, foreign trusts may be recognized by the Dutch courts under certain conditions.

Last modified 6 Dec 2019

**Are there any other notable risks or issues around lending?**

There are no specific Dutch law risks around lending.

**Generally**

Although there are no specific Dutch law risks around lending, regard needs to be had to certain general doctrines of law (comparable to similar doctrines in non-Dutch jurisdictions) when extending loans, such as ultra vires, corporate power, fraudulent conveyance and other laws of general application.

**Specific types of lending**

Lending to consumers is highly regulated under the Dutch Financial Supervision Act (Wet op het Financieel Toezicht). Furthermore, based on Dutch civil law, a (special) duty of care is applicable to financial entities, including banks. This (special) duty of care entails that financial entities should, in all their activities, take the interest of their clients (consumers and non-consumers) into account. The more professional the client of the financial entity is, the less far-reaching the (special) duty of care of the financial entity towards its client will be. Please note that this concept is developed in Dutch legal precedents and that it is subject to continuous change. The (special) duty of care that a financial entity might have, is highly dependent on the specific circumstances of the case.

**Standard form documentation**

The Netherlands frequently uses standard Loan Market Association-based documentation in extending credit.

Last modified 6 Dec 2019

**Are there any other notable risks or issues around borrowing?**

There are no specific Dutch law risks around borrowing.

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD, as amended), which
outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to ‘bail in’ obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. ‘Bail in’ describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Perfection pledges over moveable assets and receivables which are pledges on a non-disclosed basis need to be registered with the Dutch tax authorities in order to become effective. Pledges over receivables pledged on a disclosed basis need to be notified to the relevant debtors concerned, whereas mortgages over real estate and registered vessels and aircraft need to be registered with the Dutch registrable property registry (kadaster).

When receivables are pledged on a non-disclosed basis, the debtor remains entitled to validly discharge the debt by paying the pledgor (as opposed to the pledgee) until the debtor has received notification of the pledge.

Guarantees have essentially three forms under Dutch law, ie joint and several liability (whereby all debtors are obliged, as their own debt, to pay the relevant obligations concerned), a suretyship (whereby a debtor guarantees the performance of the obligations of another person) and an abstract guarantee (being a guarantee payable on demand, irrespective of the existence of any underlying obligation).

What are common types of guarantees and security?

Common forms of guarantees

Guarantees have essentially three forms under Dutch law, ie joint and several liability (whereby all debtors are obliged, as their own debt, to pay the relevant obligations concerned), a suretyship (whereby a debtor guarantees the performance of the obligations of another person) and an abstract guarantee (being a guarantee payable on demand, irrespective of the existence of any underlying obligation).

Common forms of security

Pledges on shares, receivables, moveable assets, intellectual property and mortgages on registrable objects.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

The nature of the guarantee has an impact on the extent of your recourse claim (ie with a suretyship the recourse claim relates to the full amount paid under the suretyship arrangement whereas with a joint and several liability the recourse claim is limited to the amount the that concerns the joint and several debtors in their relationship with each other (dat hem in hun onderlinge verhouding aangaat).
Giving or taking security

When receivables are pledged on a non-disclosed basis, the debtor remains entitled to validly discharge the debt by paying the pledgor (as opposed to the pledgee) until the debtor has received notification of the pledge. In addition, perfection requirements need to be observed in order to create valid security (for pledges of receivables on a non-disclosed basis and pledges of moveable assets the perfection requirement is met by offering the pledge deed for registration with the Dutch tax authorities and for disclosed pledges on receivables the perfection requirement is met by notifying the relevant debtors concerned. Mortgages are perfected by registering the mortgage in the public registers).

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

- Financial Supervision Act (Wet op het financieel toezicht)
- Market Conduct Supervision Decree (Besluit gedragstoezicht financiële ondernemingen)
- Prudential Rules Decree (Besluit prudentiële regels Wft)
- Exemption Regulation (Wrijstellingsregeling Wft)
- Economic Offences Act (Wet Economische Delicten)

Consumer credit

- Financial Supervision Act (Wet op het financieel toezicht)
- Consumer Credit Act 1974 (as amended), as implemented in Book 7 of the Civil Code (Burgerlijk Wetboek)
- Consumer Credit Act (Wet op het consumentenkrediet)

Mortgages

- Financial Supervision Act (Wet op het financieel toezicht)
- Mortgage Credit Directive (2014/17/EU), as implemented in Book 7 of the Civil Code (Burgerlijk Wetboek)
- Market Conduct Supervision Decree (Besluit gedragstoezicht financiële ondernemingen)

Corporations

- Financial Supervision Act (Wet op het financieel toezicht)
- Book 2 of the Civil Code (Burgerlijk Wetboek)
- Corporate Governance Code 2016

Funds and platforms

- The European Venture Capital Funds (EuVECA) regulation (345/2013/EU)
- The European social entrepreneurship funds (EuSEF) regulation (346/2013/EU)

Other key market legislation
Capital Requirements Regulation (Regulation (EU) 575/2013)
Capital Requirements Directive (2013/36/EU) (capital requirements), as implemented in the Financial Supervision Act (Wet op het financieel toezicht)
European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)
Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)
Amended Payment Services Directive (2015/2366/EU) (payment institutions), as implemented in the Financial Supervision Act (Wet op het financieel toezicht)
Prospectus Regulation (Regulation (EU) 2017/1129/EC) (prospectus)
Anti-Money Laundering Directive (2015/849/EU), as implemented in the Act for the prevention of money laundering and financing of terrorism (Wet ter voorkoming van witwassen en financieren van terrorisme) (anti-money laundering)

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Regulatory authorization

Who are the regulators?

The Netherlands has a ‘twin-peaks’ supervisory model. This entails the division of supervision into two areas:

- prudential supervision, on the soundness of financial entities and the stability of the financial industry (this area is supervised by the Dutch Central Bank (de Nederlandsche Bank)); and
- market conduct supervision, on the market conduct of entities that are active on the financial markets (this area is supervised by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten)).

In addition, since 4 November 2014, the European Central Bank – in cooperation with the Dutch Central Bank (de Nederlandsche Bank) – carries out the prudential supervision on Dutch ‘significant banks’ directly and Dutch ‘less significant banks’ indirectly. The market conduct supervision of all - significant and less significant - banks remains with the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten).

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What are the authorization requirements and process?

Depending on the nature of a firm and the activities it intends to engage in, authorizations may be required from one or more of the European Central Bank, Dutch Central Bank (de Nederlandsche Bank) and/ or the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) for authorization.

- The European Central Bank issues banking (ie credit institution) licenses. The license application must be submitted to the Dutch Central Bank (de Nederlandsche Bank), which will then process the application in close cooperation with the European Central Bank.
- The Dutch Central Bank (de Nederlandsche Bank) issues authorizations to financial entities, including insurers, payment institutions and pension funds.
- The Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) issues Authorizations to financial entities, including investment firms, trading venues, (managers of) collective investment schemes (Alternative Investment Fund Managers and Undertakings for Collective Investment in Transferable Securities) and financial service providers.

Some of the authorization processes require a mandatory advice of the Dutch Central Bank (de Nederlandsche Bank) from the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) and vice versa. This means that the regulatory authorities cannot authorize certain entities without the opinion of the other regulatory authority in the ‘twin-peaks’ supervisory model.

All communications, including the application, may be in English (including physical meetings). If deemed necessary, eg for technical legal reasons, some documents/communications may have to be in Dutch.
As part of the authorization process, depending on the type of authorization, the regulatory authorities might assess key individuals (eg daily policymakers, members of the supervisory board) on their suitability for their prospective role within the financial entity and/or on their integrity in general.

Authorized financial entities are listed in the AFM Register (register kept by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten)) and/or DNB Register (register kept by the Dutch Central Bank (de Nederlandsche Bank)). In addition, the European Central Bank keeps a list of significant and less significant banks in countries that adopted the Euro. This list is published on its website.

Depending on the type of application, an application fee applies (ranging from €1,000 to €150,000). There may also be ongoing yearly fees applicable and fees for specific acts/authorizations of the regulatory authorities (eg a declaration of no objection). In principle, the regulator has 13 weeks, for banks 26 weeks, to decide on the application. However, in practice this term is – depending on the circumstances – often extended.

**What are the main ongoing compliance requirements?**

The main ongoing compliance requirements for authorized financial entities, include rules concerning:

- the governance structure;
- the conduct of business;
- operational management;
- proper service provision (eg know-your-customer requirements and provision of information to customers); and
- the financial health of the company (eg concerning equity capital, solvency and liquidity).

**What are the penalties for failure to be authorized?**

Failure to be authorized can, among others, lead to:

- orders for incremental penalty payments and publication thereof;
- administrative fines (with a maximum of € 5 million (exemptions may apply, eg higher fines in case of recidivism) and publication thereof;
- criminal sanctions, including a fines or imprisonment; and
- directions or public warnings.

**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

A financial entity must not carry on a regulated activity unless authorized or exempt.

Among others, the following finance and investment activities require, in principle, authorization:

- providing banking activities;
- providing investment firm activities (eg provision of execution only services, investment advice, portfolio management, equity based crowdfunding and dealing in financial instruments);
- offering alternative investment fund or undertaking for collective investment management and marketing;
- offering and/or servicing of financial products, eg investment objects and consumer credit;
- brokerage and advisory services in relation to financial products, eg investment objects and consumer credit; and
- attracting, obtaining or having the disposal of ‘callable funds’ (eg crowdfunding).

Callable funds are deposits and other repayable funds as entailed in the definition of a credit institution under the Capital Requirements Regulation (Regulation (EU) 575/2013). No authorization, but an exemption is required for financial entities in this regard. With this exemption, financial entities may for example give out bonds to the public which would normally be covered by a restriction on these activities for which authorization is required.

Consumer credit

The following activities require, in principle, authorization:

- directly or indirectly offering credit to a consumer and/or managing or performing a credit agreement with a consumer;
- providing advisory services to a consumer in relation to credit; and
- performing brokerage activities to a consumer in relation to credit (this authorization requirement may, under certain circumstances, apply to debt collection agencies).

Are there any possible exemptions?

Yes, to certain regulated activities specific exemptions/exclusions may apply.

General exclusion

Firms that have obtained authorization in another EEA member state to perform regulated activities, in principle, would not need to obtain a Dutch authorization. These firms could, in principle, ‘passport’ their EEA authorization into the Netherlands and perform the regulated activities there.

Specific exclusions

For each type of regulated activity there are a number of specific exemptions that could also apply (eg an exemption to the requirement to obtain an authorization to provide banking activities may be available for group finance companies and an exemption to the requirement to obtain an authorization to provide investment services or perform investment activities may be available for the intragroup provision of these activities/services).

Do any exchange controls or other restrictions on payments apply?

The Netherlands does not operate any exchange controls.

Imports of physical foreign currency from non-EU member states may need to be declared to customs authorities.

EU rules on payments must be complied with and there may also be anti-money laundering and tax considerations to take into account.

What are the rules around financial promotions?

Rules
The Civil Code (Burgerlijk Wetboek) and the Financial Supervision Act (Wet op het financieel toezicht) lay down several rules on promotions regarding financial products (including consumer credit, mortgage and investment services).

Financial entities should provide their services ‘carefully’. Furthermore, the rules require financial entities to ensure that financial promotional materials are accurate, clear and not misleading and recognizable as having a commercial objective. Furthermore, although exemptions apply, the information must be provided in writing and in the Dutch language.

In relation to advertisements for consumer credit services on television, radio, internet and printed media, additional rules apply, including the following requirements that:

- The advertiser must be clear about the costs of a loan, including stating the highest interest rate which may be applicable.
- The advertisement must not include promotional rates.
- A warning statement and symbol must be included in advertisements. This statement reads: ‘Attention! Borrowing money costs money’ (Let op! Geld lenen kost geld) (Warning). Other mandatory texts and illustrations as prescribed by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) must also be included.

If a consumer credit supplier does not communicate this required information, it may be held by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten) to be engaging in unfair trade practices, resulting in damage-claims and enforcement by the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten).

Furthermore, additional rules apply in relation to the advertising of complex financial products such as investment insurances or bank saving products.

As of 19 April 2019 the marketing, distribution or sale of binary options to retail investors in and from the Netherlands is prohibited; the marketing, distribution or sale of CFDs to retail investors in and from The Netherlands is restricted.

EXEMPTIONS

Several very specific exemptions apply, for example, such as the following:

- Where it is clear that mortgage credit is to be provided for the sole purpose of purchasing a house for personal use, it is not necessary to include the warning in promotional material.
- The language of the promotional information does not have to be Dutch if the consumer has asked for this and the financial entity has agreed, if parties have agreed on another applicable jurisdiction in a contract regarding a financial product or if the information is essential and the Dutch Authority for the Financial Markets (de Autoriteit Financiële Markten) has agreed on the use of the particular language.
- The information does not have to be provided in writing in cases the law provides for this (for example in case of non-personal information, if it is allowed to provide information on the website of the financial entity) or in the event that the customer has approved the information to be transmitted through another durable medium and this fits the relationship.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are private limited companies (besloten vennootschap met beperkte aansprakelijkheid, B.V.) and public limited companies (naamloze vennootschap, N.V.), both of which are body corporates with separate legal personality and limit the
liability of their members.

Funds

The most common types of legal entities for funds are private limited companies (besloten vennootschap met beperkte aansprakelijkheid, B.V.), public limited companies (naamloze vennootschap, N.V), cooperative societies (coöperatieve vennootschap, c.v.) and Mutual Funds (Fonds voor Gemene Rekening, FGR).

Is it possible to conduct lending or investment business through a branch or establishment?

Yes

Financial entities that have obtained an EEA authorization to perform lending (e.g. banks) or investment activities could, in principle, passport their EEA authorization into the Netherlands and consequently perform the activities in the Netherlands through a branch office or as a cross-border service (ie without branch office).

A branch office:

- is a member of a financial entity that has its registered office in an EEA member state other than the Netherlands;
- does not have separate legal personality; and
- permanently exists in the Netherlands.

It should be noted that, depending on the business activities, a branch may qualify as a ‘permanent establishment’ and therefore may be subject to Dutch taxation.

Moreover, depending on the offered services, branch offices (or cross-border service providers) may be subject to certain code of conduct requirements as laid down in the Civil Code (Burgerlijk Wetboek) and the Financial Supervision Act (Wet op het financieel toezicht).

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

With the implementation of the amended Payment Services Directive (EU/2015/2366), platforms providing account information services, payment initiation services and transferring payments is more and more seen in the market. Also marketplace lending remains popular.

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
• consumer loans; and
• small and medium-sized enterprises (SME) (Midden-en Kleinbedrijf or MKB) lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes P2P-type structures often operated through an electronic platform provider as well as crowdfunding and also direct to retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which
automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOocurrency?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Cryptocurrencies are at the moment not regulated, but regulators and legislators aim to regulate cryptocurrencies and virtual wallets soon (eg by way of the 5th Anti-Money Laundering Directive).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.
Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

As the Authority for Financial Markets (Autoriteit Financiële Markten) tends to broaden its regulatory authority and scope, it remains point of discussion whether robo advice may be seen as investment advice or is a merely a tool, which is not regulated. These discussions take place on a case-by-case basis.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Regulated entities, such as banks, are required to notify the Dutch Central Bank (De Nederlandsche Bank) of any material cloud outsourcings.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

GENERAL

Supervisors

The Netherlands has a ‘twin-peaks’ supervisory model. This entails that financial regulatory supervision is divided into two areas:

- prudential supervision, on the soundness of financial entities and the stability of the financial industry (this area is supervised by the Dutch Central Bank (de Nederlandsche Bank or DNB)); and
- market conduct supervision, on the market conduct of entities that are active on the financial markets (this area is supervised by the Autoriteit Financiële Markten (AFM)).

In addition, since 4 November 2014, the European Central Bank – in cooperation with DNB carries out the prudential supervision on Dutch 'significant banks' directly and Dutch 'less significant banks' indirectly. The market conduct supervision of all (significant and less significant) banks remains with the AFM.

Main laws and regulations

The main laws and regulations that apply to FinTech products are the:

- Financial Supervision Act (Wet op het financieel toezicht);
- Market Conduct Supervision Decree (Besluit gedragstoezicht financiële ondernemingen);
- Prudential Rules Decree (Besluit prudentiële regels Wft);
- exemption regulation as part of the Financial Supervision Act (Vrijstellingsregeling Wft); and
- Anti-Money Laundering Directive (2015/849/EU), as, among others, implemented in the Anti-Money Laundering Act (Wet ter
voorkoming van witwassen en financieren van terrorisme).

General financial regulatory regime

A financial entity must not carry on a regulated activity in the Netherlands unless authorized or exempt. Where FinTech products and/or applications involve financial activity which requires regulatory authorization, the entities providing such products and/or applications must be authorized.

AFM AND DNB INNOVATIONHUB

The InnovationHub is a joint initiative of the AFM and DNB. It provides support on queries that entities may have about supervision and regulations on innovative financial products and services.

The InnovationHub can be used for:

- explanation of specific supervision rules and policy rules applying to innovative products and services;
- guidance in navigating the Dutch supervisory landscape; and
- information on potential supervision issues, eg when developing an innovative concept.

REGULATORY SANDBOX

Since December 2016, AFM and DNB are easing access of innovative services to the financial services market through the regulatory sandbox. The regulatory sandbox allows for tailored supervision that is driven by meeting the purpose of the standards, rather than the standards themselves. The purpose of providing the tailored policy options is to enable market operators to roll out their innovative financial products, services and business models without unreasonable obstacles.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENTS PLATFORMS

In the Netherlands, the role of FinTech businesses in the electronic payments sector is growing. Depending on the characteristics of the performed activities, based on the Dutch Financial Supervision Act (Wet op het financieel toezicht or FSA), electronic payments platforms mostly engage in the following regulated activities for which authorization is likely to be required:

- pursuing the business of providing payment services;
- issuing electronic money; and
- conducting the business of a bank.

Pursuing the business of payment service provider

Electronic payments platforms established in the Netherlands in principle require authorization as payment service provider when pursuing the business of providing payment services (eg the execution of payments or direct debits).

Issuing electronic money

Electronic payments platforms established in the Netherlands in principle require authorization as an electronic money institution when they issue electronic money. Electronic money has four characteristics, which are set out below.

Electronic money:

- is a monetary value stored on an electronic carrier or remotely in a central accounting system;
- represents a claim on the issuer;
- is intended to be used to perform payment transactions; and
- with which payments to parties others than the issuer can be made.

Conducting the business of bank
A payment platform established in the Netherlands (eg pre-finance payment settlements) may require authorization as a bank.

REGULATION OF PEER-TO-PEER LENDERS

Peer-to-peer (P2P) lending (also known as loan based crowdfunding) is a generic term, that in itself is not regulated in the Netherlands. Whether a regulated activity in terms of Dutch regulatory law is carried out depends on the lending structure.

Based on the FSA, authorization is likely to be required for P2P lending, when it is structured in such a way that the entity performs one of the following activities:

- in the course of business offering credit to a consumer and/or advisory or brokerage services in relation thereto;
- attracting, obtaining or having the disposal of callable funds and/or performing brokerage services in relation thereto; and
- conducting the business of a bank.

Regulation of payment services

The amended European Union Payment Services Directive (2015/2366/EU) is implemented in the FSA and delegated regulations thereto.

When a person established in the Netherlands pursues the business of providing payment services, it will require authorization by the Dutch Central Bank (de Nederlandsche Bank or DNB) to become an authorized payment institution under the FSA, unless an exemption or exception applies.

- A party pursues the business of providing payment services if the payment service is an identifiably separate activity. This is, generally, not the case if the payment service is performed merely in support of principal activities of the entity that are not payment services.
- Payment services are any business pursuit listed in the Annex I to the amended Payment Services Directive.

Application of data protection and consumer laws

As of 25 May 2018, the processing of personal data in the Netherlands is regulated by the General Data Protection Regulation (Regulation (EU) 2016/679, the "GDPR"). The Dutch GDPR Implementation Act (Uitvoeringswet Algemene Verordening Gegevensbescherming) constitutes the local implementation of the GDPR in the Netherlands. Businesses (including FinTech businesses) that process personal data may be subject to the obligations set out in the GDPR. The GDPR sets out rules with regard to e.g. the grounds for processing personal data lawfully, notification obligations, transparency obligations and transfer of personal data to countries outside the European Economic Area. The GDPR empowers supervisory authorities to impose fines of up to 4% of annual worldwide turnover, or EUR 20 million (whichever is higher) for violations of the GDPR.

The Dutch Data Protection Authority (Autoriteit Persoonsgegevens or "Dutch DPA") is the authority for the supervision of the GDPR (and Dutch GDPR) Implementation Act. In relation to FinTech-related matters, the Dutch DPA may be involved insofar privacy aspects are concerned, for example by supervising compliance with the privacy provisions set out in PSD2.

CONSUMER LAWS

There are no consumer regulations specifically aimed at the FinTech industry. Businesses (including FinTech businesses) that provide services or products to consumers may be subject to certain information requirements set out in the Dutch Civil Code. These requirements are an implementation of the Consumer Rights Directive and (among other things) the Unfair Contract Terms Directive. For the provision of online services and products, additional (consumer protection) requirements may apply, eg with regard to the use of cookies, misleading advertising and unsolicited direct marketing.

The Authority for Consumers & Markets (Autoriteit Consument & Markt or ACM) is the authority for the supervision of consumer related regulations. ACM cooperates with other regulatory authorities, including the Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten) and the Dutch Central Bank (De Nederlandsche Bank), in order to stimulate and boost FinTech businesses to contribute to the competition in the financial industry.

Money laundering regulations

Although the Wwft has a broader scope, it can generally be said that where an entity is authorized and/or supervised by the DNB or AFM, it will also be obliged to comply with the Wwft obligations.

Crypto currencies and virtual wallets are set to be regulated under the implementation of the Fifth Anti-Money Laundering Directive.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Geldvoorelkaar or Lendico.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

Banks in the Netherlands are currently also either funding or starting hybrid forms of marketplace lending. For example, Rabobank launched Rabo&Co, an online platform where its high-net-worth bank clients can provide up to 49% of loans provided to entrepreneurs who are clients of Rabobank (Rabobank always provides at least 51% of the loan).

The EU is planning to adopt harmonised legislation on the operation of cross-border crowdfunding platforms.

ACCELERATORS

There are various incubators or accelerators which offer support, facilities and funding for startups, often in return for an equity stake. Well-known accelerator programs are Startup-bootcamp and Rockstart.

Venture capital and debt

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund, examples of which include Liberty Global Ventures, ABNAMRO Digital Impact Fund and Prime Ventures. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured
against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through VC.

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms such as Geldvoorelkaar, CrossLend, Lendex and Lendico, which bring individual borrowers and lenders together without the involvement of traditional banks.

**Senior bank debt and capital markets funding**

**Senior Bank Debt**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**Capital Markets Funding**

Companies that have grown to a certain size may raise finance by way of an Initial Public Offering (IPO). An IPO is the initial sale of company shares on a public exchange, such as Euronext Amsterdam.

**Incentives and reliefs**

In the Netherlands, until January 2021, interests and royalties are not subject to withholding taxes. Additionally, the Netherlands applies, under certain conditions, a full exemption on profits derived from (foreign) activities. The Netherlands also has an extensive tax treaties network that offers the possibility to repatriate profits with no, or minimal tax leakage. As a result, the Netherlands is an attractive European hub for investing in or expanding FinTech businesses worldwide. In addition, the following tax incentives may be available to FinTech businesses.

**Research and Development (R&D) Wage Tax Credit**

The WBSO (R&D tax credit) of the Ministry of Economic Affairs is intended to provide entrepreneurs an incentive to invest in research. Provided that certain conditions are met, the R&D tax credit results in a reduction of wage tax and national insurance contributions due by employers in connection with R&D activities in the Netherlands.

**Innovation Box**

The innovation box regime aims to encourage investments in technical R&D. Under the innovation box regime, profits derived from certain qualifying self-developed intangibles (e.g. software) are taxed at an effective rate of 7% if certain conditions are met.

**30% Ruling**

Only 70% of the wages of qualifying expats in the Netherlands are subject to income tax; this is because they are entitled to a substantial income tax exemption of up to 30% for a maximum period of five years.

**Advance Tax Rulings (ATRS) and Advance Pricing Agreements (APAs)**

The Netherlands has an extensive and reliable advance-ruling practice. The Dutch tax authorities can provide advance rulings for various types of structures and activities.

**No Net Wealth Tax, Stamp Duty or Lump-Sum Tax**
The Netherlands has no net wealth tax, stamp duty or lump-sum tax.

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**Portfolio sales**

**Loan transfers and portfolio sales**

**What are common ways of buying and selling loans?**

Loan portfolios are most commonly purchased by either taking assignment of the loan receivables themselves (which can take place on a disclosed or a non-disclosed basis) or by means of a ‘transfer of entire contractual position’ (whereby both rights and obligations under the relevant loans are transferred).

The concept of novation is not known under Netherlands law and, in the event that non-Dutch law governed loan agreements are transferred by means of novation, there is a real risk that underlying Dutch security can be extinguished as, under Dutch law, the continued existence of security rights is codependent on the continued existence of the claim they purport to secure.

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**What are the main considerations when transferring a loan and related security?**

In order to affect a ‘transfer of entire contractual position, the consent of all the parties to the agreement is required if not given in advance.

Bankers liens are commonplace in the Netherlands whereby a bank takes security for all present and future obligations of a debtor. While these types of security can prove useful for the purposes of cross collateralization (and cross acceleration), careful structuring is required if loan portfolios are transferred to transferee lenders whilst the transferor lender still has the benefit of bankers liens (which, if not terminated appropriately, can give the transferor lender the benefit of the relevant security for new claims it originates on the debtors concerned).

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**Projects**

**Financing / investing in energy / infrastructure**

**To what extent are energy and infrastructure assets publicly or privately owned?**

**Generally**

The ownership of infrastructure assets in the Netherlands varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

**Energy**

Pursuant to mandatory EU law requirements, gas and electricity industries in the Netherlands are privatized, with generation, transmission, distribution and supply services provided by a number of private sector companies. Entities carrying out eg transmissions...
services are limited in their ability to eg carry out supply services and vice versa. The relevant private sector companies own the generation, transmission and distribution assets. TenneT TSO B.V. (Tennet), a fully state-owned entity, is the sole owner and operator of the Netherlands’ high voltage transmission grids.

Regional TSOs own and operate regional distribution grids supplying household and (limited) commercial consumers; Tennet distribution grids link regional grids and link the Dutch energy grid to other EU member state and Norway’s distribution grid through land and marine interconnectors (eg NorNed and Britned interconnectors). For future offshore energy project purposes, Tennet has been designated the sole TSO required by law to organise, facilitate and operate offshore grids. On certain (existing) offshore projects, private entities other than Tennet may own transmission lines; Interconnector ownership is shared between participating TSOs such as National Grid and Tennet in case of Britned.

In certain instances, including on major energy infrastructure, projects may be procured by the public sector and depending on the terms of the procurement, the asset may either be publicly or privately owned.

From a public policy perspective and in accordance with international agreements entered into by the Netherlands among other parties, there is an impetus towards sustainable power generation instead of fossil fuel power generation which is embodied mostly in direct subsidies and grants (SDE+) and partly (for smaller scale projects) via local tax incentives.

The Netherlands Authority for Consumers and Markets (ACM) is the principal body with responsibility for regulation of the energy sector in the Netherlands.

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in the Netherlands are privately owned by a number of service providers. The Netherlands Authority for Consumers and Markets (ACM) is the principal body with responsibility for regulation of the telecommunications sector in the Netherlands.

Transport infrastructure

NATIONAL RAIL

The Dutch Railway Act determines the roles, responsibilities and authorizations of the parties involved in rail transport (government, infrastructure management, transport companies and supervisory bodies). The Dutch government legally owns the railway track.

Dutch Railways (NS) is the largest national passenger rail transport company in the Netherlands and all its shares are held by the Dutch State, with more than 1 million travelers per day and approximately 4,800 train journeys on the Netherlands' 2,100 kilometers of railways. To do so, NS has almost 3,000 railway cars with seating for more than 260,000 passengers. NS is also responsible for the commercial exploitation of 380 stations not owned by the company.

NS does not operate trains on all of the railway lines in the Netherlands. Regional governments are currently responsible for many regional and urban rail services, which are not part of the main railway network. Other companies provide passenger rail services on 14 railway lines with a total of almost 700 kilometers of track: eg Syntus, Arriva, Connexxion, DB Regionalbahn Westfalen and Prignitzer Eisenbahn.

Cargo rail operators use the same Dutch railway network as well. Deutsche Bahn subsidiary Railion is the predominant cargo rail operator in The Netherlands.

ProRail, a private company whose sole shareholder is the Dutch State, is responsible for construction, maintenance and management of the Dutch rail network, including all relevant facilities such as tunnels, overpasses, overhead power lines, signals, switches and stations, on behalf of the national government. ProRail also allocates capacity on the rail network and is responsible for rail traffic control.

The Human Environment and Transport Inspectorate, Rail and Road Transport unit (Inspectie Leefomgeving en Transport), monitors the safety of the rail transport system on behalf of the national government.

LIGHT RAIL

Light rail tracks are mostly owned by the local public sector. Private companies in general own the trams and subway cars. For example, the Municipality of Amsterdam owns the track and supporting infrastructure in Amsterdam, while trams, tubes and busses are owned by a private company, GVB Activa B.V.
AVIATION

Aviation in the Netherlands is privatized. With regards to airport infrastructure, there are a mixture of ownership structures including private ownership, (local) government ownership and various forms of public-private ownership. All models are regulated by the Dutch government and the Dutch Civil Aviation Authority.

PORTS

The Port of Rotterdam (which is Europe's largest port and operated by an unlisted public limited company held 70% by the Rotterdam Municipality and 30% by the Dutch government) and the Amsterdam Port Region (a separate entity whose shares are held by the Amsterdam Municipality) are the largest ports in The Netherlands with access to both sea and inland waterways. Both have official designated tasks in relation to eg nautical safety but also manage the use of the harbors. Port operations (ie cargo handling, storage, loading and unloading) are handled by the private sector.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector with the exception of Social Housing projects (please see below) with the private sector's responsibility being for any or all of the design, build, financing, operation and maintenance of the infrastructure. The majority of social infrastructure assets in the Netherlands are directly financed by the government.

Education

School infrastructure ownership may vary; while primary and secondary school legislation is based on the premise that school boards (either separate entities or municipal authorities) are owners of school buildings and premises this legislation does not prohibit third party ownership. These distinctions also affect the course of effects after the termination of the use of a building as a school; if the building construction costs were paid from a municipal budget, in principle title of ownership of the building will revert to the municipality.

Hospitals

Ownership of public hospitals is mostly held by public sector bodies

Social housing

This is a diverse sector involving many different organizations and individuals including housing developers, building contractors, mortgage lenders, local authorities, housing associations, landlords, owner-occupiers, private renters and those in the social rented sector. Typically, on a social housing project, housing associations own the relevant housing stock. Although housing associations tend to be private limited companies their governance is constrained by public sector regulation and, effectively, operate as quasi-public sector entities.

DEFENSE

Typically, defense assets are owned by the public sector.

WASTE

While municipalities operate waste collection facilities, many waste treatment or collection facilities are operated also by the private sector, who would be responsible for design, build, operation or maintenance of the facility. Certification and registrations in addition to material environmental law requirements apply in relation to any operations involving waste, in order to ensure proper handling of waste.

WATER

Water and wastewater services in the Netherlands are delivered by enterprises whose tasks and obligations are statutorily set and whose business operation is subject to statutory requirements and administrative monitoring, which own the relevant infrastructure assets. The Water Boards and the Directorate-General for Public Works and Water Management are responsible for safeguarding and quality of surface water. The Water Boards and the Province manage groundwater. According to the Drinking Water Act, all these parties are collectively responsible for the protection of the Netherlands' water resources.
Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in the Netherlands over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (e.g., merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered.

For example, a project involving development on land will require planning permission and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on 'change of control'. This is less of a concern on private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy markets in the Netherlands have a complex system of arrangements between suppliers, generators, transmission and distribution, which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanisms with suppliers, customers and TenneT and these are subject to change/regular updates meaning that investors must have a good understanding of the current framework and the potential directions in which the market may move.

Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable. This is particularly relevant in relation to the SDE+ subsidies, which may be essential to ensure that sustainable power production can occur while being price competitive but whose conditions set strict requirements in relation to change of control particularly in the early stages of projects.

Telecoms infrastructure

There is a complex regulatory environment for this sector including how access and interconnectors (between networks) are regulated under the Telecommunications Act. The rights required to access private or public land in order to install and maintain essential equipment in, over or under that land should also be considered carefully. This equipment might be cables sunk beneath the ground or a mobile mast sited on the ground.

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

Transport infrastructure

ROADS

For certain types of road projects, procuring public sector authorities (i.e., central government or a local authority) may delegate certain of their duties to private sector partners. Investors assuming such duties will, therefore, need to understand the nature and extent of the duties they are assuming and whether they are able to subcontract these duties to an appropriate person. There is usually a restriction on the change of control of a private sector partner during the construction period. Following the construction period, the private sector may be allowed a change of control subject to certain restrictions. The precise scope of the restrictions will depend on the contractual terms.

Other infrastructure

On publicly-procured infrastructure, it is quite common for long-term projects to have a 'change in control' clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the construction period, but this is often relaxed subject to certain restrictions. How strict these restrictions are will often depend on the...
sector. For example, the defense sector usually gives the Ministry of Defense a strong degree of discretion (particularly on the grounds of national security) as to whether to accept a change in control over its private sector partner.

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What is the applicable procurement process?

Public procurement in the Netherlands is governed by the Dutch Procurement Act 2012 which contains a national implementation of the three EU Directives on concessions, government sectors and the special sectors as well as a (limited) national framework.

The key principles are that contracts procured by the public sector must be awarded transparently, based on objective and proportionate requirements and criteria and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

Investing in energy and infrastructure

Public procurement is relevant where the Dutch government, or a branch of it, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would be financing a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to the State, a province, a municipality, the Water Boards and bodies governed by public law.

In most cases, the public sector will need to publish a contract notice in the Official Journal of the European Union (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects where a dialogue with tenderers is necessary in order to find solutions that fulfil the contracting authority's needs and requirements. It involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification is allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer's bid.

- **Competitive procedure with negotiation** – This procedure can be used under the same circumstances as the competitive dialogue and is suitable for complex infrastructure projects. Main difference with the competitive dialogue is that the negotiations in a competitive procedure with negotiation are not aimed at finding a solution, but at improving the received bids (price and/or quality aspects). The minimum requirements and award criteria cannot be negotiated.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves. However, the procurement regulations on modification of contracts and significant changes can be a point of attention.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

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What are the most common forms of funding / investing in energy and infrastructure?

Funding
The most common forms of funding both energy and infrastructure projects is by means of a combination of debt and equity structures. The debt structures can vary but most commonly are senior only structures. Repayment profiles are, as is the case with energy and infrastructure projects internationally, adopted to have regard to the cash flow ability of the investment concerned.

**Investing**

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**Restructuring**

**Enforcement and sanctions**

**When can there be regulatory investigations?**

If the Authority for the Financial Market (de Autoriteit Financiële Markten) or the Dutch Central Bank (de Nederlandsche Bank) considers that an authorized firm or regulated individual may have breached ongoing compliance requirements, it can launch a formal investigation. This may result in criminal or administrative sanctions.

**What regulatory penalties may apply?**

The following regulatory penalties may, among others, apply:

- orders for incremental penalty payments and publication thereof;
- an administrative fine (with a maximum of €5 million) (exemptions may apply) and publication thereof;
- withdraw regulated status against the financial entity; and
- informal measures, including an instruction by the regulator, a letter of warning or a disciplinary discussion.

**What criminal penalties may apply?**

Following formal investigation, an offence can be charged criminally. The Dutch regulators do not have criminal powers themselves. They will have to report the criminal offence to the District Attorney, who can then decide whether or not to prosecute the offence.

Offences that can be charged criminally include:

- insider dealing and misleading statements and practices;
- breaches of the Money Laundering Regulations; and
- conducting regulated activities when not authorized.

The criminal penalty could entail a fine, a community service order and/or imprisonment.
Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

No stamp, registration, transfer or other similar taxes are payable on the taking, transfer or assignment of a mortgage, debenture or other security. Registration fees may apply to the registration of mortgages on the Public Register (but this will usually be dealt with, in practice, by the notary arranging the notarial deed).

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over the tax authorities (Belastingdienst) on enforcement of a security.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

No, there is no withholding tax on interest payments.

However, interest payments on hybrid loans are subject to withholding tax because hybrid loans are treated as equity. A loan is a hybrid loan if for example (i) the amount of interest due depends on the profits of the debtor, (ii) the loan is subordinated to all other creditors, and (iii) the loan has no fixed maturity (or has a maturity of 50 years or longer). If these conditions are met, the interest payments made by the debtor are re-qualified as dividends for tax purposes and consequently subject to 15% dividend withholding tax.

If so:
What is the rate of withholding?

N/A.

What are the key exemptions?

N/A.
Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g., by virtue of incorporation, residence or local branch)?

No, unless the lender holds 5% or more of the shares in the borrower, and holds its participation with tax avoidance being the primary goal or one of the primary goals. In that instance, the lender is charged with corporate income tax at a rate ranging between 19% and 25% in 2019 and 16.5% and 25% in 2020, depending on the total amount of income received.

Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes.

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Key contacts

Lex Oosterling
Partner
DLA Piper Nederland N.V.
lex.oosterling@dlapiper.com
T: +31 20 5419 948
New Zealand

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Issues of debt securities to retail investors are regulated under the Financial Markets Conduct Act 2013 (FMCA). Debt securities must be issued under a compliant trust deed and offers must be made in a registered product disclosure statement, and a licensed supervisor must be appointed to act on behalf of the holders of the debt security and supervise the issuer’s performance. The supervisor is a party to the trust deed, with certain rights held in trust by the supervisor for the benefit of the holders of the debt securities.

Non-bank deposit takers (NBDT) are regulated under the Non-Bank Deposit Takers Act 2013. NBDTs make regulated offers of debt securities to retail investors and carry on the business of borrowing and lending money, but are not registered banks. NBDTs are licensed and prudentially regulated by the Reserve Bank of New Zealand. Issues of debt securities by NBDTs are regulated under the FMCA (as above).

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in New Zealand are bonds or notes issued on a stand-alone basis or under a program. These can be as corporate or State-Owned Enterprise bonds, bills of exchange, commercial paper and promissory notes.

Many different types of debt securities are offered in New Zealand. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (i.e. debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
• warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

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**What are the differences between offering debt securities to institutional / professional or other investors?**

The Financial Markets Conduct Act 2013 (FMCA) regulates the issuing of debt securities to retail investors. Retail investors are investors who do not fall within the definitions of wholesale investors in the FMCA. Wholesale investors include:

• investment businesses;

• a person who meets certain 'investment activity' criteria;

• a person who is 'large' (net assets or turnover of more than NZD$5million);

• a government agency; and

• an eligible investor who certifies that they fall within certain criteria.

A person is also a wholesale investor if the minimum amount payable by the person on acceptance of the offer is at least NZD$750,000.

Warning statements and acknowledgements need to be given to eligible investors. Otherwise issuers of debt securities to wholesale investors only need to comply with the conduct obligations in Part 2 of the FMCA, which apply to all financial service providers.

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**When is it necessary to prepare a prospectus?**

It is necessary to register a product disclosure statement for all regulated offers of managed investment products, derivatives, debt securities and equity securities. A regulated offer is an offer made to a retail investor.

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**What are the main exchanges available?**

The main exchange is the NZX Main Board. It is privately owned by NZX Limited, which itself is a listed company. NZX operates five other markets – NZX Debt Market, NZX Dairy Derivatives Market, NZX Equity Derivatives Market and the Fonterra Shareholders’ Market. Market operators are licensed by the Financial Markets Authority under the Financial Markets Conduct Act 2013.

There are three other licensed market operators in New Zealand – ASX 24 (operated by Australia Securities Exchange Limited), ICE Futures USA and ICE Futures Europe. There are also some smaller unlicensed secondary markets such as Unlisted.

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**Is there a private placement market?**

Both New Zealand banks and some non-financial corporates make use of private debt markets.

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**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Debt securities may only be issued to retail investors under a product disclosure statement that complies with the Financial Markets
Conduct Act 2013 (FMCA). Misleading or deceptive statements in a product disclosure statement or any advertising can lead to civil and criminal liability under the FMCA.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

The establishment, management and offering of funds (managed investment schemes) are regulated under the Financial Markets Conduct Act 2013.

A managed investment scheme means a scheme to which each of the following applies:

- the purpose or effect of the scheme is to enable persons taking part in the scheme to contribute money, or to have money contributed on their behalf, to the scheme as consideration to acquire interests in the scheme;
- those interests are rights to participate in, or receive, financial benefits produced principally by the efforts of another person under the scheme (whether those rights are actual, prospective, or contingent, and whether they are enforceable or not); and
- the holders of those interests do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).

An interest in managed investment scheme is a managed investment product.

What are common fund structures?

The most common fund structures are open-ended (managed funds) and closed-ended (e.g. property funds), both retail and non-retail. Most are established as unit trusts although limited partnerships are becoming more common, particularly for property-related funds. Funds will also typically become Portfolio Investment Entities to obtain certain New Zealand tax benefits.

Discretionary investment management services are an alternative investment mechanism whereby a financial advisor (authorized under the Financial Advisors Act 2008 or licensed under the Financial Markets Conduct Act 2013) can acquire and dispose of assets on behalf of an individual using the investor’s funds in accordance with an agreed Investment Authority.

What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Retail funds must comply with a range of registration requirements, have a licensed manager and a licensed supervisor, and have compliant offering documents. The fund's assets must be held by the supervisor or an independent custodian, and investments must be undertaken in accordance with a registered statement of investment policy and objectives. Retail funds are subject to a high level of regulatory oversight by the Financial Markets Authority (FMA).
Institutional/professional funds

Funds offered to wholesale investors (as defined in the Financial Markets Conduct Act 2013 (FMCA)) do not have to comply with the same requirements as retail schemes. The FMA’s oversight of wholesale funds is limited to conduct obligations under the Fair Dealing provisions in Part 2 of the FMCA. Indications are that FMA will look to increase its scrutiny of wholesale funds in the future.

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Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Funds that are offered to retail investors must comply with a range of compliance obligations in the Financial Markets Conduct Act 2013 (FMCA), including having a licensed manager and licensed supervisor.

Currently discretionary investment management service (DIMS) providers must be either authorized under the Financial Advisors Act 2008 (FAA) or licensed under the FMCA. From 29 June 2020 all DIMS providers will need to be licensed under the FMCA.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Marketing of retails funds is strictly regulated under the Financial Markets Conduct Act 2013. Disclosure documents must comply with heavily prescribed regulatory requirements, and a great deal of information must be placed on the public register.

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Are there any restrictions on managing a fund?

The manager of a retail fund must be licensed by the Financial Markets Authority (FMA). The licensing process is comprehensive with significant ongoing monitoring by the licensed supervisor of the fund and the FMA. Capital adequacy requirements must be met and restrictions apply to related party transactions. Investment must be made in accordance with the fund's registered statement of investment policy and objectives.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Derivatives contracts can only be offered to retail investors by a licensed derivatives issuer. Licenses are issued by the Financial Markets Authority (FMA) under the Financial Markets Conduct Act 2013 (FMCA). The licensing process is comprehensive with significant ongoing monitoring by the FMA.

There are no restrictions for offering derivatives contracts to wholesale investors apart from conduct obligations under the Fair Dealing provisions in Part 2 of the FMCA.

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What are common types of derivatives?

Derivatives contracts are entered into in New Zealand for a range of reasons including hedging, trading and speculation.
The four most common types of derivatives are futures, forwards, options (call options and put options) and swaps (such as interest rate or currency swaps).

These are either privately traded over-the-counter derivatives or exchange-traded derivatives.

The value of the derivatives contracts is based on the value of the underlying assets. The main classes of underlying asset seen in the New Zealand are:

- equity;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

*Are there any other notable risks or issues around entering into derivatives contracts?*

The issuing of derivatives in New Zealand was largely unregulated until the coming into effect of the Financial Markets Conduct Act 2013 (FMCA) on 1 December 2014. A small number of issuers were approved as Authorized Futures Dealers by the previous regulator, the Securities Commission, under the now-repealed Securities Markets Act 1988. Those issuers were transitioned to the FMCA by 1 December 2016, and there are currently 25 licensed derivatives issuers. The FMA has taken enforcement action against derivatives issuers operating from outside of New Zealand who have registered to the Register of Financial Service Providers and claimed to be regulated in New Zealand without being licensed. Several of these businesses have been struck off the register.

*Debt finance*

*Lending and borrowing*

*Are there any restrictions on lending and borrowing?*

**Lending**

Yes.

The Credit Contracts and Consumer Finance Act 2003 places restrictions on advertising content related to consumer loans. The Responsible Lending Code imposes on lenders of consumer finance and credit contracts obligations to abide by when issuing loans. Financial institutions do not have to be registered banks in order to take deposits and make loans. Banks may face restrictions on residential home loan lending due to Loan to Value Ratio (LVR) restrictions imposed via bank registration conditions. These restrict banks on the amount of low deposit lending they can do. Note that this only applies to residential investment and would exclude commercial transactions.

**Borrowing**

When borrowing money secured over residential homes by mortgage, certain LVR restrictions exist. These restrictions specify the minimum deposit requirements when buying an owner-occupied property to live in or when buying residential investment property. Certain exceptions do apply.

Non-bank deposit takers must comply with the Non-Bank Deposit Takers Act 2013.
What are common lending structures?

Lending in New Zealand can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, e.g. term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities etc.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed or limited resource. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and therefore is less burdensome from a compliance perspective.

Lender Responsibility Principles will only apply to consumer credit contracts (except for consumer leases). Subject to this, parties are generally free to contract on their own terms and conditions subject to restrictions which apply generally (for example in relation to
Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of New Zealand law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. There are few general risks or issues particular to lending transactions (such as usury laws or similar), beyond these risks which generally arise in other jurisdictions.

There is a renewed focus on conduct with new standards being imposed on financial service providers to ensure that they serve the needs of customers, treat customers fairly, recognise and prioritise customer interests and effectively manage conflicts of interest. The FMA is expecting this to be actively monitored and managed by boards and senior management with legislation implementing new conduct licensing regime expected to be introduced in Parliament by the end of 2019.

Specific types of lending

Loan-to-value ratios limit New Zealand banks on the amount of low-deposit residential mortgage lending. Banks and other institutions must abide by prudent lending standards.

Standard form documentation

Banks and other consumer finance providers typically use their own standard form loan agreements and security documents for transactions under NZD2 million, and often for larger transactions also.

Are there any other notable risks or issues around borrowing?

A range of legislative protections and standards exist in relation to consumer finance transactions, or transactions with individuals (as distinct from companies, trusts or other entities), such as those under the Credit Contracts and Consumer Finance Act 2003, Fair Trading Act 1986 and the Consumer Guarantees Act 1993.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

There are no general restrictions in New Zealand on the giving and taking of guarantees. Guarantees are usually taken in the form of a deed, with appropriate witnessing, to avoid the need for the guarantor to receive consideration or benefit in order to enforce the guarantee.
Lender responsibility principles exist when giving and taking guarantees in relation to a consumer credit contract. Every creditor that takes a guarantee of a consumer credit contract has disclosure obligations to the guarantor as part of this obligation.

**Capacity**

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors’ powers that would be preventative. Under New Zealand law, directors have a general duty to promote the success of the company for the benefit of its members as whole; as such, they will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

**Insolvency**

Guarantees and security may be at risk of being set aside under New Zealand insolvency laws if the guarantee or security was granted by a company or individual within a certain period of time prior to the onset of insolvency. This would be the case if the company giving the guarantee or security received inadequate consideration, and as such, the transaction was at an undervalue. For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within two years of the onset of insolvency of the affected party. Guarantees and security may also be challenged on other grounds relating to insolvency.

**Major transactions**

In respect of companies incorporated in New Zealand, if the amount guaranteed is greater than half the value of the gross assets of the company, the approval of 75% of the shareholders of the company is generally required before the grant of the guarantee, unless the grant is conditional on later approval in that manner.

**Financial assistance**

It is unlawful for a company to provide financial assistance for the purchase of its own (or of its holding company's) shares unless relevant shareholder and director approvals are obtained and a certificate from directors relating to solvency given. Financial assistance in this context would include giving a guarantee or security in connection with the share purchase.

Last modified 13 Dec 2019

**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees can take a number of forms.

A particular distinction worth remembering is between a performance guarantee and a payment guarantee:

- **A performance guarantee** is a term used to describe both performance bonds (in the context of trade finance) and ‘see to it’ guarantees (in other contexts):
  - A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.
  - A ‘see to it’ guarantee is a promise by the guarantor to see to it that the primary obligor fulfils its obligations under the primary contract. If the primary obligor fails to fulfil its obligations under the primary contract, the guarantor will be in breach of its obligations under the guarantee.

- **A payment guarantee** is narrower in scope than a performance guarantee as it only covers the payment of money rather than other contractual obligations.

Other types include rental guarantees, advance payment bonds, collateral guarantees, bid, tender, warranty bonds, custom bonds and
Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing, signed by the guarantor and provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations will usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this should not be an issue. Also it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary, for example between the borrower and lender. As a result, guarantees are often executed as deeds to avoid any argument about whether good consideration was provided. Deeds have particular execution requirements under New Zealand law which need to be observed.

Additionally, there is a risk that a guarantee may be set aside if it was procured by undue influence by a borrower or lender. A party being provided with a guarantee should be alive to this issue and take steps to avoid claims of undue influence by, for example, requiring the guarantor to take separate legal advice.

Lender responsibility principles exist when taking guarantees. Failure to abide by these could result in issues for the guarantor. Every creditor that takes a guarantee of a consumer credit contract has disclosure obligations to the guarantor as part of this obligation.

Giving or taking security

A security document may need to be executed as a deed if it:

- contains a mortgage over land;
- confers a statutory power of sale and power to appoint a receiver; or
- contains a power of attorney.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having
the secured asset delivered to the security holder, registration of the security and notice being given to third parties. Mortgages over land are registered on on-line electronic land titles register - Land Information New Zealand, also known as LINZ. Security interests over non-land assets are protected by registering a finance statement on the New Zealand Personal Property Securities Register.

There are no general notarization requirements for security documents under New Zealand law.

Like guarantees, for a period after a new security interest has been granted (known as the hardening period), it is at risk of being set aside in certain circumstances under insolvency laws. Reviewable transactions include those conducted at an undervalue and preferences and invalid floating charges.

Financial regulation

Law and regulation

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

- Anti-Money Laundering and Countering Financing of Terrorism Act 2009
- Personal Property Securities Act 1999
- Fair Trading Act 1986
- Consumer Guarantees Act 1993
- Corporations (Investigation and Management) Act 1989
- Commerce Act 1986

**Consumer credit**

- Credit Contracts and Consumer Finance Act 2003
- Land Transfer Act 2017
- Property Law Act 2007

**Mortgages**

- Credit Contracts and Consumer Finance Act 2003

**Corporations**

- Companies Act 1993
- Limited Partnerships Act 2008

**Funds and platforms**

- Financial Markets Conduct Act 2013
- Financial Markets Conduct Regulations 2014
- Financial Service Providers (Registration and Dispute Resolution) Act 2008
- Financial Advisors Act 2008
- Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014
- Financial Services Legislation Amendment Act 2019

**Other key market legislation**

- Non-Bank Deposit Takers Act 2013
Regulatory authorization

Who are the regulators?

The Financial Markets Authority (FMA) regulates the conduct of financial service providers in both retail and wholesale markets and is responsible for enforcing securities, financial reporting and company law as they apply to financial services and securities markets. The FMA also authorizes and regulates licensed financial product markets.

The Reserve Bank of New Zealand regulates banks, insurers and non-bank deposit takers and manages monetary policy to maintain price stability, promotes the maintenance of a sound and efficient financial system, and supplies New Zealand banknotes and coins.

The Commerce Commission enforces competition, fair trading and consumer credit laws. Together with the Ministry of Business, Innovation and Employment (MBIE) and the Treasury, these five regulators form the Council of Financial Regulators in New Zealand.

The Inland Revenue has responsibility for the collection of tax and the administration of the Inland Revenue Acts in New Zealand, including the Income Tax Act 2007.

What are the authorization requirements and process?

The Financial Markets Conduct Act 2013 (FMCA) includes a licensing regime for providers of market services in New Zealand. Application fees range from NZD2,139 to NZD10,695.

All financial service providers with a place of business in New Zealand (including those who do not need to be licensed under the FMCA) must register under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Annual registration fees apply. From 29 June 2020 the registration requirements will change requiring every person who is in the business of providing a financial service to retail clients to register if those financial services are provided to persons in New Zealand, regardless of where the financial services are provided from.

Registration under the Reserve Bank of New Zealand Act 1989 is required if an entity wishes to use a name or title that includes restricted words ('bank', 'banker', 'banking' or any other derivatives) for banks or classes of banks licensed overseas, representative bodies and associated persons of a registered bank, unit trust associated with a registered bank or non-financial institutions. Specific conditions of authorization are required for each of the different types of entity.

Any entity can apply to become a registered bank with the Reserve Bank of New Zealand. They take into account a number of factors (qualitative and quantitative) when determining an application.

To become an Authorized Financial Advisor you must meet a number of eligibility requirements prescribed by the Financial Markets Authority. This includes registering on the Financial Service Providers Register and joining a dispute resolution scheme. From 29 June 2020, any person who provides a financial advice service will be required to be licensed under new provisions in the FMCA.

Non-bank entities that take deposits from the public need to obtain a license under the Non-Bank Deposit Takers Act 2013.

What are the main ongoing compliance requirements?

Registered banks are required to meet minimum prudential, reporting and other standards on an ongoing basis, and comply with specific and standard conditions of registration.

Failure to comply can result in sanctions for banks and, in serious cases, loss of registration.
Key prudential requirements for banks operating in New Zealand relate to capital, liquidity, governance, disclosure, credit ratings, outsourcing, connected exposures, open bank resolutions and macro prudential issues. The Reserve Bank of New Zealand has the discretion to take enforcement action and to decide what enforcement action to take for non-compliance.

There is also legislation expected to be introduced into Parliament by the end of 2019 which would implement a new conduct licensing regime (regulated by the Financial Markets Authority) for banks, insurers and non-bank deposit takers requiring these entities to meet high standards of fair customer treatment and regulating sales target-based incentives. Providers of financial services in New Zealand must be registered under the Financial Services Provider (Registration and Dispute Resolution) Act 2008 and, if those services are provided to retail clients, must join an approved dispute resolution scheme.

When entering into a consumer credit contract, lenders must comply with 'lender responsibilities'. This includes providing clear and concise information, helping the borrower make informed decisions, assessing affordability, ensuring that the credit agreement is not oppressive and that the borrower is not treated oppressively.

Any financial advisor has disclosure obligations to meet and must exercise care, diligence and care when carrying out its required conduct obligations.

Reporting entities have obligations imposed on them by the Anti-Money Laundering and Countering Financing of Terrorism Act 2009. These obligations include: carrying out a risk assessment, design; implementation and maintenance of a compliance program that sets out procedures, policies and internal controls; undertaking customer due diligence; and monitoring and reporting suspicious transactions.

Audits, reviews and an annual report must be submitted to the relevant anti-money laundering/countering financing of terrorism supervisor.

**What are the penalties for failure to be authorized?**

An unregistered individual that knowingly breaches the Financial Service Providers (Registration and Dispute Resolution) Act 2008 by providing a financial service without being registered, or is not a member of an approved dispute resolution scheme could be liable to a term of imprisonment of up to 12 months and/or a fine of up to NZD100,000. For a person that is not an individual this fine cannot exceed NZD300,000.

Providing a financial advisor service without permission can lead to a fine between NZD10,000 and NZD50,000 whereas holding out as an authorized financial advisor can result in a fine for the individual of up to NZD10,000 and of up to NZD50,000 for an entity.

Providing a market service without a license may give rise to civil liability for a pecuniary penalty of up to NZD200,000 for an individual and up to NZD600,000 in any other case. A range of other civil liability orders are available, including compensatory orders. From 29 June 2020 this will also apply to persons providing financial advice service without a license.

A person that falsely holds itself out as a registered bank can be penalized. An individual can be imprisoned for up to 18 months or to a fine of up to NZD200,000. A body corporate can be fined up to NZD2 million.

**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

The Financial Markets Conduct Act 2013 (FMCA) requires managers of managed investment schemes, supervisors of managed investment schemes and debt issuers, independent trustees of restricted superannuation schemes, issuers of derivatives, providers of discretionary investment management services, and crowd funding and peer-to-peer lending platform providers to be licensed. From 29 June 2020 providers of financial advice services will also be required to be licensed under the FMCA.
Consumer credit

The Financial Services Providers (Registration and Dispute Resolution) Act 2008 requires businesses that provide a financial service to be registered and be a member of an approved dispute resolution scheme.

A financial service means:

- a financial advisor service;
- a broking service;
- a licensed non-bank deposit taker;
- a registered bank;
- dealing with investment portfolios and securities;
- being a creditor under a credit contract;
- operating a money or value transfer service;
- issuing and managing means of payments such as credit and debit cards;
- a licensed market service;
- acting as a custodian of a registered scheme;
- operating a financial product markets;
- changing foreign currency;
- trading financial products or foreign exchange on behalf of other persons;
- providing forward foreign exchange contracts;
- acting as an insurer;
- giving financial guarantees;
- participating in a regulated offer of financial products as the issuer or offeror; and
- acting in any of the following capacities in respect of an offer of regulated products or financial products:
  - as an issuer;
  - as a supervisor; or
  - as an investment manager.

A person or entity wishing to use the word 'Bank' or related words in its name is required to be registered under the Reserve Bank of New Zealand Act 1989.

Are there any possible exemptions?

The Governor General may make regulations exempting any service or person from registration under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP). He or she can prescribe specific terms and conditions of the exemption if required.

The minister responsible for the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 may exempt requirements of the Act such as reporting obligations.

The Financial Markets Authority (FMA) can grant exceptions to having to register under the FSP or to having to comply with obligations under the Financial Advisors Act 2008; this is provided when the cost of compliance would be unreasonable or not justified by the benefit of compliance or that the relevant person, transaction or service was adequately regulated by an overseas jurisdiction to the standard of
Under the Financial Markets Conduct Act 2013 general exemptions apply for services being provided to wholesale investors and for certain other types of offers. Specific exemptions can also be granted by the FMA on an individual or class basis.

Exemptions exist regarding the use of a restricted word under the Reserve Bank of New Zealand Act 1989 where the word signifies a geographic place name, the name of a natural person or that it could not be reasonably mistaken as being the name of a financial institution.

**Do any exchange controls or other restrictions on payments apply?**

There are no exchange controls on foreign-exchange transactions undertaken in New Zealand, either by New Zealand residents or non-residents. The New Zealand dollar has a floating exchange rate and there are no restrictions on the amount of funds which may be brought into or taken out of New Zealand.

Anti-money laundering controls may apply in certain circumstances.

**What are the rules around financial promotions?**

**Rules**

Regulated offers of managed investment products, debt securities and equity securities are required to be made in a registered product disclosure statement prepared in accordance with the Financial Markets Conduct Act 2013. A regulated offer is an offer made to a retail investor. General fair dealing provisions also apply with respect to disclosure.

**Exemptions**

Exemptions apply to offers made to wholesale investors and certain other types of offers.

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

The most common form of legal entities are limited liability companies established under the Companies Act 1993. Another common form of investment entity is a limited partnership. Both are bodies corporate with separate legal personality that limit the liability of their members (shareholders/limited partners). Trusts, often with corporate trustees, are also commonly used as a vehicle for private investment.

**Funds**

Managed investment schemes are usually established as unit trusts. Limited partnerships are becoming more commonly used as investment entities, particularly for closed-ended schemes.

Managers and other type of issuers are usually established as companies.
**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes.

Overseas companies can register branches of their companies in New Zealand. Consent may be required from the Overseas Investment Office (OIO) if the business involves the acquisition of a 'significant business assets' or 'sensitive land' in New Zealand.

Standard compliance requirements will apply to the branches.

Any reporting entity under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) must ensure its branches in a foreign country comply. Failing to ensure branches and subsidiaries comply with the AML/CFT Act could result in civil liability.

Specific tax rules apply to loans made by or to a New Zealand branch.

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**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Peer-to-peer funding platforms and marketplace lending**

Peer-to-peer (P2P) funding matches people who want loans with people who are potentially willing to fund those loans. The matching is done through an intermediary platform – a P2P lending service.

In New Zealand, the provision of a P2P lending service is a market service that requires a license from the Financial Markets Authority under the Financial Markets Conduct Act 2013.

A person provides a P2P lending service if:

- they provide a facility by means of which offers of debt securities are made; and
- the principal purpose of the facility is to facilitate the matching of lenders with borrowers who are seeking loans for personal, charitable or small-business purposes.

**HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?**

Marketplace lending includes P2P-type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis. However, it is relevant to note that there is currently no permitted secondary market for investments in marketplace lending platforms in New Zealand.

**ISSUES FOR STARTUP MARKETPLACE LENDERS**

The requirements for a P2P lending service license (including governance and management requirements, as well as operational functionality) are not insignificant; and New Zealand currently offers no regulatory sandbox or testing period. The integrity of credit scoring and servicing/collections processes have been critical to establish funding support for existing marketplace lenders.

It is also important for startup marketplace lenders to ensure that the platform's interest and fees structure is fully compliant with
applicable consumer credit regulation, while still providing sufficient revenue for the platform (and yield for investors). Anti-money laundering and fraud prevention processes must also be considered.

As well as the initial incorporation, licensing and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform (for instance, through securitization).

Blockchain, smart contracts and cryptocurrencies

**WHAT IS BLOCKCHAIN?**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (e.g. in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.
WHAT IS A CRYPTOCURRENCY?

A cryptocurrency is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding.

It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- a prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’, are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Personalised ‘robo advice’ is currently prohibited in New Zealand under the Financial Advisors Act 2008 (FAA). An exemption was granted in June 2018 to allow entities to provide personalised digital advice on approval by the Financial Markets Authority. Currently 8 entities
have been approved to provide digital advice facilities under the exemption. From 29 June 2020 new provisions in the Financial Markets Conduct Act 2013 will come into effect which provide for licensing of entities wishing to provide digital financial advice services.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

All persons providing financial services by way of business must be registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA) and, if providing services to retail customers, be a member of an approved disputes resolution scheme.

The Financial Markets Authority (FMA) is the licensing body and market conduct regulator for persons who are registered, licensed, appointed, accredited or authorized under the Financial Markets Conduct Act 2013 (FMCA) (discussed below), the Financial Markets Supervisors Act 2011, the Financial Advisors Act 2008 and the FSPA.

The Reserve Bank of New Zealand (RBNZ) is the conduct regulator for registered banks, non-bank deposit takers and licensed insurers.

GENERAL

Under the FMCA, a person must not provide a market service without holding, or being authorized to provide the service under, a market services license from the FMA that covers the service. A ‘market service’ includes acting as a:

- manager of a registered managed investment scheme;
- provider of a discretionary investment management service;
- peer-to-peer (P2P) lending intermediary;
- crowdfunding intermediary; and
- from 29 June 2020, a financial advice service.

An offer of financial products that is received by a retail investor in New Zealand will require disclosure and will be regulated under the FMCA unless the issuer demonstrates that it has taken all reasonable steps to ensure that retail investors in New Zealand may not accept the offer.

Where FinTech products and applications involve financial activity which requires regulatory authorization, then firms providing such products and applications must be authorized by the FMA.

THE FMA’S APPROACH TO FINTECH

It is an express purpose of the FMCA to promote innovation and flexibility in the financial markets.

The FMA has stated that it wants to see innovative financial products and services coming to market, delivering customer benefits and supporting the integrity of New Zealand’s capital markets. It will encourage innovation where it improves the range or quality of financial services in New Zealand. The amendment of the FMCA to provide for licensed digital financial advice services is an example of this.

The FMA has so far discounted the use of a regulatory sandbox in New Zealand but has said that it will maintain an open and flexible approach for businesses that wish to engage with the FMA at an early stage on innovation in financial services and that it will also ensure
that it supports an appropriate environment for innovation to flourish.

Electronic payments platforms and regulation of peer-to-peer lenders

Electronic payment platforms

Retail payment systems are used to transfer funds from consumers to merchants in exchange for goods and services. They include credit and debit cards, the EFTPOS system, as well as cash, checks and bank transfers.

Retail payment systems are subject to relatively light-handed regulation in New Zealand.

Peer-to-peer lenders

A P2P lending service is one where a person provides a facility by means of which offers of debt securities may be made, and the principal purpose of the facility is to facilitate the matching of lenders with borrowers who are seeking loans for personal, charitable or small business purposes.

Providing a P2P lending service requires a market services license from the FMA. The eligibility criteria for a P2P lending services license under FMCA include the following.

- The provider has fair, orderly and transparent systems and procedures for the service.
- The service is designed primarily for offers by persons other than the provider.
- The provider has adequate systems and procedures for checking the identity of each issuer of debt securities, assessing the risk of investors not being repaid in full or not receiving interest and for disclosing information about that checking and assessment to investors.
- The provider has a fair dealing policy to exclude issuers that have engaged in misleading or deceptive conduct.
- The provider has adequate systems and procedures for ensuring that each issuer does not raise more than NZD2 million in any 12-month period under the service.
- The provider has adequate systems and procedures for handling conflicts of interest.

Regulation of payment services

Retail payment systems are used to transfer funds from consumers to merchants in exchange for goods and services. They include credit and debit cards, the EFTPOS system, as well as cash, cheques, bank transfers and new forms of app-based payment.

Retail payment systems are subject to relatively light-handed regulation in New Zealand:

- RBNZ has a mandate to promote the maintenance of a sound and efficient financial system; however the performance and efficiency of retail payment systems are not the primary focus of the RBNZ.
- Payments New Zealand is the operator of a number of payment systems in New Zealand (including the Consumer Electronic Clearing System, which includes proprietary EFTPOS) but has no role in determining the allocation of costs or incentives within retail payments systems or the business models that schemes operate under. It was established in 2010 by eight banks with a mandate to open access to and preserve the integrity of New Zealand’s payment systems. Forty organisations now make up the Payments NZ community - 12 Participants (banks and financial institutions) and 28 Members (payment system organisations (such as card schemes, merchants, smaller non-shareholding banks, tech providers, retailers, fintechs and payments infrastructure owners) that want to be actively involved in the ongoing development and strategic direction of payment systems.

In February 2016, the New Zealand government asked the Ministry of Business, Innovation and Employment (MBIE) to examine whether New Zealand’s retail payment systems were producing good economic outcomes. In particular, MBIE asked are:

- consumers and merchants benefiting from ongoing innovation in payment systems;
- card payment systems being used efficiently; and
- consumers and merchants bearing a fair share of the costs?
Following a public consultation process, Payments NZ have been working with industry to advance the Payments Direction strategic initiative and engaging with banks and card schemes to improve the transparency of merchant service and interchange fees. The Payments Direction initiative aims to deliver a core payments system that:

- simplifies and removes friction from customers’ payment experiences;
- gives customers choice across a greater range of value propositions;
- enables newcomers to partner and compete with existing players;
- ensures relevant opinions are heard in relation to design and governance matters; and
- balance innovation with preserving security and need to meet increasingly complex compliance requirements.

By 2020, Payments NZ is expecting to have endorsed the implementation of a shared application programming interface (API) framework and a 365-day service availability for the settlement before interchange (SBI) system - both of which are key initiatives aimed at future-proofing the core payments system. Other key priorities include investigating and developing opportunities relating to the use of proxy identifiers to identify bank accounts, request to pay (API-enabled push payments), speeding up payments and the ISO 20022 payments messaging format.

**Application of data protection and consumer laws**

The Privacy Act 1993 governs the collection, use and disclosure of personal information and the access by individuals to that information. Following a comprehensive review, this will be repealed and replaced with a new Privacy Act which is currently progressing through Parliament and expected to come into force in 2020. Amongst other things, the new legislation proposes stronger powers for the Privacy Commissioner, mandatory reporting of privacy breaches, new offences and increased penalties.

The Unsolicited Electronic Messages Act 2007 regulates and prohibits unsolicited commercial electronic messages with a New Zealand link from being sent and requires commercial electronic messages to include accurate information about the person who sent the message and a functional unsubscribe facility. The act also prohibits address-harvesting software or a harvested-address list from being used to send unsolicited messages in contravention of the act.

The Credit Contracts and Consumer Finance Act 2003 sets out the requirements for borrower disclosure, responsible lending processes and reasonable fees in the context of consumer lending.

New Zealand has trade practices and fair dealing legislation that requires all businesses to ensure that they do not engage in misleading or deceptive conduct, make unsubstantiated claims or enter into unfair contract terms with consumers.

**Money laundering regulations**

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 has the purposes of:

- detecting and deterring money laundering and the financing of terrorism;
- maintaining and enhancing New Zealand’s international reputation by adopting (where appropriate in the New Zealand context) recommendations issued by the Financial Action Task Force; and
- contributing to public confidence in the financial system.

Generally, where a firm provides a financial service by way of business and is required to be registered under the FSPA, it will be supervised by the FMA for compliance with anti-money laundering requirements.

If a reporting entity establishes a business relationship or conducts an occasional transaction or activity that involves new or developing technologies, or new or developing products, that might favor anonymity (such as bitcoin and other cryptocurrencies), the reporting entity must take any additional measures that may be needed to mitigate and manage the risk of such technologies or products being used in a money laundering offence.

_Last modified 13 Dec 2019_
What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family, friends and close business associates of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

Offers of financial products by a FinTech business to its close business associates (directors, senior managers, etc) or to relatives of directors do not generally require disclosure under the Financial Markets Conduct Act 2013 (FMCA).

SMALL OFFERS

Offers of financial products by a FinTech business to persons who are likely to be interested in the offer (having regard to previous contact with that person or that person’s statements or actions) do not require disclosure under the FMCA if the financial products are equity or debt securities and provided that not more than NZD2 million is raised from not more than 20 investors in any 12-month period.

CROWDFUNDING

The crowdfunding sector is well established in New Zealand, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through a licensed crowdfunding service, such as Snowball Effect or Equitise.

In New Zealand, a person provides a crowdfunding service if they provide a facility by means of which offers of shares in a company are made and the principal purpose of the facility is to facilitate the matching of companies who wish to raise funds with many investors who are seeking to invest relatively small amounts. Providing a crowdfunding service in New Zealand requires a market services license issued by the Financial Markets Authority (FMA). The eligibility criteria for a license for a crowdfunding service include requirements that the provider has:

- fair, orderly and transparent systems and procedures for providing the service;
- an adequate anti-fraud policy;
- adequate disclosure arrangements to give investors information to assist in the decision to acquire shares;
- an adequate fair dealing policy;
- adequate systems to ensure that each issuer does not raise more than NZD2 million in any 12-month period under the service; and
- adequate systems for handling conflicts of interest.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access. Offers of shares are limited to NZD2 million in any 12-month period.

ACCELERATORS

There are various angel networks, incubators or accelerators in the New Zealand market which offer support, facilities and funding for startups, often in return for an equity stake.

Venture capital and debt

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund. The benefit of having a CVC as an
An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through VC.

NEW ZEALAND VENTURE INVESTMENT FUND

The New Zealand Venture Investment Fund (NZVIF) was established by the New Zealand government in 2002 to build a vibrant early stage investment market in New Zealand. It has NZD245 million of funds under management which are invested through two vehicles: the NZD195 million Venture Capital Fund of funds and the NZD50 million Seed Co-investment Fund.

NZVIF does not invest directly into companies but makes its investments either through privately managed VC funds, or alongside experienced angel investors, who it partners with to invest into New Zealand-originated, high-growth potential companies. NZVIF can invest up to NZD25 million into a new VC fund, provided there is at least matching private sector support, a demonstrable track record and an experienced team.

Warehouse and platform funding

FinTech platforms (such as peer-to-peer (P2P) lending platforms) may be able to source institutional funding lines from domestic and international lenders and investors, with those funds available to be lent out through the platform. Access to this type of platform funding depends on the availability of funders with an understanding of, and risk appetite for, exposure to the relevant asset class (e.g. P2P loans).

Warehouse financing may be available for FinTech companies which own or can offer exposure to a sizeable portfolio of assets. The funding is secured by assets acquired by a special purpose trust from the originator. The senior lenders will typically only fund a portion of the assets, with the remainder being financed by way of mezzanine lending and/or subordinated lending from the originator.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

FinTech companies will often start out with overdraft arrangements from a bank supported by the company's directors or shareholders.

Once a FinTech company is more established and has a track record and asset base, bank debt becomes a more viable source of funding for working capital, accounts management and liquidity purposes. In contrast to capital markets funding, which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility.

CAPITAL MARKETS FUNDING

New Zealand has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) is a potential funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the NZX.

Larger FinTech companies may also access funding by issuing bonds to wholesale or retail investors as a way of raising more competitive funding, but retail issues involve significant regulatory compliance costs under the FMCA.

Another potential funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

Incentives and reliefs

CALLAGHAN INNOVATION

Callaghan Innovation is a government agency in New Zealand and is tasked with supporting hi-tech businesses in New Zealand with innovation. It is one of the government's key priorities to build a stronger, more competitive economy for New Zealand and to boost the growth of firms in the manufacturing and services sector.
Callaghan Innovation’s main objective is to support science and technology based innovation and its commercialization by businesses in order to improve their growth and competitiveness. It achieves this objective by providing research and development grants, access to experts and undertaking collaborative projects to reduce research and development costs and share industry knowledge.

RESEARCH AND DEVELOPMENT LOSS TAX CREDIT

The aim of the research and development (R&D) loss tax credit is to allow startup companies (with an R&D focus) to refund tax losses caused by qualifying R&D expenditure.

To ‘cash out’ any tax losses from R&D expenditure the startup must meet the eligibility criteria. To be eligible the company must:

- be a tax resident in New Zealand;
- have a net loss in the corresponding tax year;
- have eligible R&D expenditure for the income year;
- have sufficient R&D wage intensity;
- meet the corporate eligibility criteria; and
- own (solely or jointly) the intellectual property and know-how that results from the R&D activity.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio subject to overarching terms.

The most common ways of selling loans are as follows.

Assignment

An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment may be able to be achieved without the consent of the debtor. An assignment can be effected as either an equitable assignment or legal assignment depending on whether certain statutory requirements have been satisfied.

Novation

A novation is a full legal transfer of the party’s rights and obligations by agreement. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

Sub-participation

A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

What are the main considerations when transferring a loan and related security?
There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent of or notification to any other parties. Unless the debtor is notified of the assignment, the debtor can still repay the assignor and be released from the debt despite the assignment to the assignee.

Projects

Financing / investing in energy / infrastructure

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The extent of public and private infrastructure ownership varies significantly between the five key infrastructure sectors in New Zealand: energy, telecommunications, transport, water and social sectors.

Each of these sectors is considered below.

It is also worth noting that in 2019 New Zealand created its own Infrastructure Commission. A new independent infrastructure body, the New Zealand Infrastructure Commission - Te Waihanga, has been established to ensure that New Zealand gets the quality infrastructure investment needed to improve its long-term economic performance and social wellbeing. It is not a delivery vehicle.

**Energy**

Five major companies generate 95% of New Zealand's electricity (and also themselves, or through related entities, sell electricity at retail). Three of these companies have mixed public/private ownership, with the Crown holding a majority stake. The remaining two major electricity-generating companies are privately-owned.

Transpower New Zealand Limited owns and operates the national electricity transmission infrastructure (the 'national grid') and is a state-owned enterprise. There are 29 distribution companies which own the lines connecting consumers to the national grid. These companies and their assets are owned by a mix of publicly listed companies, shareholder co-operatives, community trusts and local government.

Distributors' arrangements with retailers permit retailers to provide consumers with electricity via the distributor's lines. Retailers are privately owned – except for the three large 'gentailers' in which the Crown holds a majority share.

With the exception of one company (Genesis Energy Limited), gas and oil assets at the production, wholesale, transmission and distribution levels are owned by private sector companies.

The Electricity Authority regulates the electricity industry and the Gas Industry Company regulates the gas industry. Electricity transmission, some electricity distribution businesses and gas pipeline businesses are subject to Commerce Commission (New Zealand's competition and consumer law regulator) price-quality regulation.
Telecoms infrastructure

Telecommunications infrastructure is largely privately owned. Historically, fixed-line broadband and telephone services are mostly have been provided through copper-based networks, although fiber-based services are now increasingly common with the government’s ultra-fast broadband initiative aiming to achieve 87% national coverage by 2022 (significant additional rural broadband and mobile coverage will also be deployed around New Zealand between 2019 and 2023 due to the expansion of the rural broadband initiative phase two/mobile black Spots fund (RBI2/MBSF) programme. Chorus, a private-sector company specifically regulated by the Telecommunications Act 2001, owns and operates the copper network on an open-access basis for retail service providers. Mobile services are wholly provided by the private sector.

As noted above, the government has invested heavily in building an ultra-fast broadband fiber (UFB) network. Crown Infrastructure Partners (CIP), a Crown-owned company, is responsible for managing the UFB network on the Crown’s behalf.

Telecommunications providers are regulated by the Commerce Commission.

Transport infrastructure

ROADS

Almost all roads in New Zealand are publicly owned. The State Highway network, which connects towns and cities, is managed on behalf of central government by the New Zealand Transport Agency (NZTA). Local roads are owned and managed by local government in association with NZTA.

Roads and other land transport infrastructure are funded through the National Land Transport Fund, which is administered by the NZTA. The NZTA makes funding decisions in accordance with national and regional land transport plans. NZTA commonly outsources work on state highways to private sector suppliers.

AVIATION

Airports vary considerably in scale and utilization. New Zealand has eight civil airports designated by the New Zealand Customs Service to receive international flights, five of which have regular scheduled international services. 26 airports receive regular domestic services.

Most airports are owned by local government, while some have part ownership by central government or the private sector. Auckland International Airport is owned by Auckland International Airport Limited, a company listed on the New Zealand and Australian stock exchanges. The Auckland City Council retains a 22% ownership in the airport.

Airways New Zealand, a state-owned enterprise, provides air navigational infrastructure.

Aviation capacity is provided by the approximately 26 domestic and 20 international passenger carriers which operate in New Zealand. This infrastructure is for the most part privately provided. Air New Zealand, the national airline, carries approximately 80% of domestic traffic and 40% of international traffic. Air New Zealand is listed on both the New Zealand and Australian stock exchanges, while the Crown retains a 52% ownership.

RAIL

KiwiRail, a state-owned enterprise, owns and controls the rail tracks, associated infrastructure and rolling stock. The rail corridor is technically owned by New Zealand Railways Corporation (also a state-owned enterprise) with KiwiRail licensed to manage the land for a nominal fee.

Wellington and Auckland are the only cities in New Zealand with metropolitan rail services. The metropolitan rolling stock is owned by the respective local government organizations, each of whom contracts the operation of its passenger rail services to the private sector. Transdev is currently contracted to operate both the Wellington and Auckland passenger rail services.

SHIPPING AND PORTS

New Zealand has 16 ports servicing both domestic and international movements. Many are 100% owned by local government, while others have part private ownership.
KiwiRail owns and operates the Interislander, a passenger and freight ferry service connecting the North and South Islands of New Zealand. The Interislander competes with Bluebridge, a private sector company also offering freight and passenger service between the two islands.

**Other infrastructure**

**EDUCATION**

School infrastructure ownership varies among the three types of school: state school, ‘state-integrated’ school and private school. State schools are entirely owned and funded by the government, with boards of trustees responsible for their governance. Private schools are entirely privately owned, typically by a trust, and are not required to offer the national curriculum.

State-integrated schools are former private schools which are regulated like state schools (for example, they follow the national curriculum) but the ownership of school land and buildings is retained by the private owners. Representatives of the private owners sit as trustees on the school’s board of trustees.

Historically, opportunities have existed for investment in education infrastructure through New Zealand’s Public-Private Partnership (PPP) program (although, at the time of writing, the current Labour-led government has ruled out PPPs in the social infrastructure space). In the New Zealand context, a PPP is a long-term contract for the delivery of a service, where provision of the service requires the construction of a new asset, or enhancement of an existing asset, that is financed from external (private) sources on a non-recourse basis, and full legal ownership of the asset is retained by the Crown.

PPP contracts in the education sector have typically involved the Ministry of Education engaging a private partner to design, finance, build and maintain a particular school. The Crown still owns the land and buildings.

**HOSPITALS**

New Zealand has both a public and private healthcare system. Public hospitals are owned by District Health Boards, who receive central government funding and are responsible for providing and funding health services in their district. Private hospitals are owned and operated by private owners, typically trusts or companies.

**SOCIAL HOUSING AND HOUSING RELATED INFRASTRUCTURE**

Social housing in New Zealand is provided by a combination of central government (through Kinga Ora), local government and private sector Community Housing providers.

Created in 2019, Kinga Ora brings together the people, capabilities and resources of the Government’s KiwiBuild Unit, Housing New Zealand and its development subsidiary HLC. This change has been designed to enable a more cohesive and joined-up approach to delivering the government’s priorities for housing and urban development in New Zealand. These priorities include addressing homelessness and making homes more affordable for New Zealanders.

Kinga Ora has two key roles:

- being a public housing landlord; and
- partnering with the development community, Mori, local and central government, and others on urban development projects of all sizes.

At the time of writing, new Infrastructure Funding and Financing (IFF) legislation has been recently introduced to Parliament with bi-partisan support. IFF is a new, user-pays tool for funding local roading and water infrastructure. Crown Infrastructure Partners is expected to play a major role in facilitating investment and projects using this legislation.

**WATER**

Much of New Zealand’s water infrastructure is used for agricultural purposes. According to the World Bank, 74% of New Zealand’s fresh water withdrawals go towards agriculture. Ownership of agricultural irrigation infrastructure varies. Many irrigation projects are owned by
farming co-operatives with varying degrees of investment from local government. Historically central government has played a role in accelerating the development of rural water infrastructure projects through the Irrigation Acceleration Fund (although, this fund was closed by the Labour-led government in 2019).

Domestic water supply infrastructure is owned by local government. Many local authorities directly manage the supply of drinking water, while others contract out the operational and maintenance services.

At the time of writing, the government is in the process of creating an independent water body to regulate drinking water in New Zealand (noting this is a quality, rather than an economic, regulator).

Are there special rules for investing in energy and infrastructure?

Generally

New Zealand has an open economy which operates on free market principles. New Zealand maintains specific foreign investment restrictions in only a few areas of critical interest. There are no specific restrictions on foreign direct investment in the energy and infrastructure industries. Overseas persons investing in New Zealand energy and infrastructure assets or businesses must:

- comply in all respects with the general law of New Zealand in the same way as a New Zealand investor; and
- if applicable, apply for and receive consent from the Overseas Investment Office (OIO) in respect of the particular investment.

Overseas investments in New Zealand assets are screened if they are defined as ‘sensitive’ within the Overseas Investment Act 2005. Three broad classes of asset are currently defined as sensitive within the Act: acquisition of a 25% or more ownership interest in business assets valued at over NZD100 million, all fishing quota investments, and investment in ‘sensitive land’ as defined in Schedule One of the Act. Examples of sensitive land include: residential land, rural land over five hectares; or land bordering or containing foreshore, seabed, river or the bed of a lake.

Proposed investments must meet certain statutory criteria before requiring OIO consent. Once met, this will usually require investors to show their business experience, that they are of good character and, for sensitive land, demonstrate the benefits to New Zealand of their investment.

Investors who need OIO consent:

- generally do not have New Zealand citizenship or are persons who are not ordinarily resident in New Zealand;
- are entities, such as companies, trusts and joint ventures, with more than 25% overseas ownership or control; and
- can include associates (including New Zealanders) of overseas investors.

The most effective way for an overseas person to invest in New Zealand will depend upon practical matters relating to the nature of the investment and the resulting tax consequences in New Zealand and elsewhere.

Overseas persons generally undertake business in New Zealand by:

- incorporating a local company as the subsidiary of an overseas company;
- registering a branch of an overseas company in New Zealand; or
- establishing a joint venture or partnership.

Subject to tax and anti-money laundering reviews, there are no specific restrictions on the movement of funds in or out of New Zealand, or on repatriation of profits. Other than under the terms of any OIO consent, no additional performance measures are imposed on foreign-owned enterprises.

Energy

The energy markets in New Zealand are heavily regulated by the Electricity Authority, the Gas Industry Company and the Commerce Commission. Securing licenses and consents to develop certain natural resources may trigger a process which requires consultation with
local iwi (Maori tribes).

Although a central body manages the electricity market, electricity generation is separated from electricity distribution. Transpower, a state-owned enterprise, owns and operates the entire transmission infrastructure. Electricity generators cannot transmit electricity unless directly to a customer. Distributors enter into transmission agreements with Transpower, as prescribed by the Electricity Industry Participation Code. This code also provides for the processes by which purchasers and generators submit and revise bids and offers for electricity.

The majority of electricity in New Zealand is generated through hydroelectric dams. There is increasing pressure on the country's freshwater resources, resulting in the Land and Water Forum making ongoing recommendations to the government about freshwater management and preservation. Government implementation of these recommendations will influence the allocation of freshwater for electricity generation.

Geothermal energy is an emerging industry governed by unusual rules. No individual or business can own a geothermal resource, but consents can be awarded for development and use under the Resource Management Act 1991. There is no licensing regime under which rights to investigate geothermal resources can be secured.

The oil industry is regulated by New Zealand Petroleum and Minerals. The government has rights to all oil in New Zealand and in the country's Exclusive Economic Zone. The Crown Minerals Act 1991 and its related regulations governs the allocation rights to oil resources.

**Telecoms infrastructure**

The telecommunications industry is essentially separated into network owners, who own the infrastructure (including fixed line and fibre), and retail service providers, who purchase wholesale broadband and voice services from network owners to on-sell to consumers. The wholesale price that network owners can charge to retail services providers is controlled by the Commerce Commission. Due to ‘unbundling’ of local loop infrastructure (cabling which connects an exchange to an end consumer), retail service providers are also able to install their own infrastructure in exchanges, giving them more control over the quality of their service.

There is some regulation in place to support new mobile service providers. However, retail service providers looking to enter the market face limited choices when looking for commercial agreements for roaming and co-location on mobile towers. Competition regulations do not impose price controls on owners of mobile infrastructure. The Commerce Commission undertook a mobile market study in 2019.

**Transport infrastructure**

Opportunities exist for investment in transport infrastructure through the government's Public-Private Partnership (PPP) program. There are currently two major transport PPPs underway for the construction of major expressways. A PPP is one option for the light rail project proposed for Auckland and it is expected that further projects will be identified as the Infrastructure PlanCommission develops a 30 year infrastructure plan.

*Last modified 13 Dec 2019*

**What is the applicable procurement process?**

Private sector procurement is governed by the ordinary laws of New Zealand. As noted above, foreign investors may need to obtain consent from the Overseas Investment Office before entering into certain transactions. Foreign investment is otherwise generally not subject to any further restrictions.

Public sector entities must comply with good public sector procurement practices when contracting with private sector suppliers. The Government Rules of Sourcing (GRS), issued by the Ministry of Business Innovation and Employment, provide a broad framework of rules and best practice guidelines for government procurement. The GRS apply on a mandatory basis to almost all executive government organizations and a number of Crown entities. Other non-core public sector and local government organizations may also be obliged to take the GRS into account as guidance for good practice. In addition to the GRS, each public sector entity has its own procurement policy.

The GRS apply to government contracts when the maximum total estimated value meets or exceeds:

- in relation to contracts for goods and services, NZD100,000 or more; or
- in relation to contracts for construction works, NZD9 million or more.
The broad objective of the GRS is to ensure that procurement decisions are fair, transparent, lawful and provide value for tax payer money. A decision not to award a contract to tenderer cannot be made on the basis that they are a foreign-owned or controlled entity.

Government procurement opportunities are advertised on a web-based service called Government Electronic Tender Service (GETS). GETS is accessible to all interested suppliers, both domestic and international. It meets New Zealand's commitments under free trade agreements. Government agencies are also permitted to consider unsolicited proposals from the private sector, subject to certain restrictions.

Construction procurement guidelines have recently been developed which set out the standards of good practice for government agencies to apply to their construction projects.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of sector funding in energy and infrastructure in New Zealand are:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases. Such loans may later be syndicated to other funders;
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing.

Funding is often sourced from offshore.

The most common form of investment in energy and infrastructure is equity investment in joint ventures, special purpose vehicles or entities that may have a portfolio of interests (share capital and subordinated sponsor loans).

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

The Reserve Bank of New Zealand has the power to appoint any person to carry out an investigation of the affairs of a registered bank or an associated person of that registered bank when it is satisfied that it is:

- necessary or desirable to give directions when it has reasonable ground to believe that the registered bank or associated person is insolvent, likely to be insolvent, is about to suspend payment or is unable to meet obligations;
- the business of the bank is not being carried out in a prudent manner;
- the affairs or circumstances surrounding the bank or associated person are such as to be prejudicial to the soundness of the financial system; and
- the bank or associated person fails to comply with a requirement under the Financial Markets Conduct Act 2013 (FMCA) or has been convicted of an offence under the Reserve Bank of New Zealand Act 1989.

Similar powers exist under the Corporation (Investigation and Management) Act 1989 in relation to the statutory management of companies and other entities. Enforcement of a security may be suspended while a company or other entity is subject to statutory management.
The Financial Markets Authority (FMA) has extensive powers under the Financial Markets Authority Act 2011 to:

- obtain information, documents and evidence where FMA considers it necessary or desirable for the purposes of performing its functions, powers or duties under that Act or any financial markets legislation (including the FMCA);

- enter and search places, vehicles and other things for the purpose of ascertaining whether a person has engaged in or is engaging in conduct that constitutes or may constitute a contravention of any provision of financial markets legislation where there are reasonable grounds to suspect that there is a contravention and that the search will find evidential material; and

- share information and documents with other law enforcement agencies, regulators or overseas regulators that the FMA considers may assist those agencies' performance or exercise of their functions, powers or duties under an enactment or foreign law (but only where the overseas regulator can provide appropriate protections for the purpose of maintaining the confidentiality of anything provided).

FMA may also use any information, or copy of any documents, provided to it by a law enforcement or regulatory agency under any enactment, or by an overseas regulator, in the FMA's performance of its functions, powers or duties.

The FMA also has powers under the FMCA to intervene in debt securities offered under a regulated offer and in registered managed investment schemes. Auditors and other parties such as investment managers and custodians have a duty to report serious problems in respect of debt securities or managed investment schemes to the FMA (or the supervisor of a managed investment scheme). The FMA can direct the supervisor, issuer or manager to take action in respect of serious problems reported to it, or apply for court orders to remedy problems. There is a wide range of civil liability provisions in the FMCA relating to contraventions of the FMCA by issuers and managers. Criminal liability only applies where there has been a deliberate breach.

**What regulatory penalties may apply?**

The Reserve Bank of New Zealand has the discretion to take enforcement action and to decide what enforcement action to take. Registered banks could be subject to de-registration.

Examples of penalties in the Financial Markets Conduct Act 2013 are:

- fines of up to NZD50,000 for infringement offences;
- injunctions;
- banning orders;
- loss of license;
- pecuniary penalty orders (the maximum being the greater of the consideration for the transaction, three times the amount of the gain made or loss avoided, or NZD1 million for an individual and NZD5 million in any other case);
- compensatory orders; and
- other civil liability orders.

**What criminal penalties may apply?**

Criminal offences can apply under the Reserve Bank of New Zealand Act 1989 when the offences relate to:

- the supply of information;
- the registration of banks;
- disclosure statements; and
- the prudential supervision of registered banks (amongst other miscellaneous provisions).

The maximum term of imprisonment can be up to 18 months or a fine of NZD200,000 for an individual or in the case of a body corporate...
of up to NZD2 million.

Criminal offences under the Financial Markets Conduct Act 2013 apply for deliberate defective disclosure and making false statements. The maximum penalty for individuals is 10 years’ imprisonment and/or a NZD1 million fine, and in any other case a NZD5 million fine.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There are no stamp duties, registration or transfer-type taxes currently imposed in New Zealand. In some circumstances a loan that comes within the Approved Issuer Levy ('AIL') regime will need to be registered with Inland Revenue.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There are no stamp duties, registration or transfer-type taxes currently imposed in New Zealand. In some circumstances a mortgage, debenture or other security that comes within the Approved Issuer Levy ('AIL') regime will need to be registered with Inland Revenue.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

There are no stamp duties, registration or transfer-type taxes currently imposed in New Zealand. In some circumstances debt securities that come within the Approved Issuer Levy ('AIL') regime will need to be registered with Inland Revenue.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Generally not, but whether or not the Inland Revenue has priority over secured lenders/secured debt security holders will depend on a number of factors (including whether and when the security interest has been perfected, the nature of the tax owed to the Inland Revenue and the status of the debtor (e.g. whether it is in liquidation)). On a liquidation, the Inland Revenue can have priority in some circumstances.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Yes, generally New Zealand imposes withholding tax on interest payments under a loan.

If so:
What is the rate of withholding?
The rate of withholding varies.

For interest paid to recipients resident for tax purposes in New Zealand, the rate of resident withholding tax (RWT) differs according to the type of recipient. For most corporates, the rate is 28% (or 33% if it chooses the higher rate), whereas individuals can elect a rate which reflects their marginal tax rate (10.5%, 17.5%, 30% or 33%). However, if the recipient (corporate or individual) has not provided its taxpayer identification (IRD) number to the payer, the rate defaults to 33%.

For interest paid to recipients not resident for tax purposes in New Zealand, the rate of non-resident withholding tax (NRWT) is 15% unless either:

- the approved issuer levy (AIL) regime has been applied to the loan and the requirements of the regime are met (including payment of a 2% or 0% levy), in which case NRWT is reduced to 0%; or
- a reduced rate applies under an applicable double tax treaty.

What are the key exemptions?

The key exemptions from the requirement to deduct withholding tax from interest payments to recipients resident for tax purposes in New Zealand apply where the recipient holds a certificate of exemption (or, from 1 April 2020, has RWT-exempt status) – persons who may apply for a RWT exemption certificate (or, from 1 April 2020, RWT-exempt status) include registered banks, those in the business of borrowing and lending money, portfolio investment entities (a tax status for certain collective investment vehicles), certain large taxpayers (gross income in excess of NZD2 million), and certain persons deriving exempt income (e.g. charities).

The key exemptions from the requirement to deduct withholding tax from interest payments to recipients not resident for tax purposes in New Zealand apply where:

- the loan is under the AIL regime and the requirements of the regime have been met (including payment of the 2% levy or the loan is NZD dominated listed debt that qualifies for AIL at a rate of 0%), then NRWT is reduced to 0% (note: this is a reduction as opposed to an exemption);
- the interest is paid by a transitional resident and other requirements are met;
- the Commissioner of Inland Revenue has relieved the person of the obligation to withhold NRWT (although it is unlikely that this power would be exercised); or
- an applicable double tax agreement provides an exemption, in whole or in part.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.
Key contacts

Michael Thompson
Partner
DLA Piper New Zealand
michael.thompson@dlapiper.com
T: +64 9 300 3866
Norway

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Norwegian and EU law, the latter of which is almost always incorporated into Norwegian law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Norway or to request that they are admitted to trading on a regulated market operating in Norway unless an approved prospectus has been made available to the public.

What are common issuing methods and types of debt securities?

In Norway the most common debt securities are bullet bonds, where the interest is paid at regular intervals until the full amount is due, whereupon the entire par value is payable.

There are several types of debt securities in Norway. Some common forms include:

- different types of bonds with varying repayment and interest rates, such as coupon bonds, zero-coupon bonds, secured bonds, covered bonds, unsecured or senior bonds, government bonds, and convertible and contingent convertible bonds; and

- short-term loan certificates that are tradable debt securities.

What are the differences between offering debt securities to institutional/professional or other investors?

The Norwegian prospectus rules do not make a distinction between professional and other investors for the purposes of its disclosure requirements but do include different disclosure regimes by reference to the minimum denomination of a single security.

However, for more information, see Issuing and investing in debt securities – requirement for prospectus. Section 7-4 number 8 of the Securities Trading Act of 2007 states that the provision of section 7-2 does not apply where the offer is addressed to professional investors pursuant to further rules laid down by the ministry in regulations.
When is it necessary to prepare a prospectus?

Section 7-2 of the Securities Trading Act 2007 states that where an offer to subscribe for or purchase transferable securities is addressed to 150 or more persons in the Norwegian securities market, and involves an amount of at least €1 million calculated over a 12-month period, a prospectus shall be prepared in accordance with the rules of chapter 7 of the Securities Trading Act chapter 7. The same applies where an offeror residing in Norway makes an offer in another European Economic Area (EEA) state and the prospectus requires approval pursuant to section 7-7 of the Securities Trading Act. Chapter 7 implements the EEA directives (EF) 2003/71 and (EF) 2004/809.

It is also necessary to prepare a prospectus upon admission to trading of transferable securities in a Norwegian regulated market place, including increases of capital in companies with quoted shares. The same applies where an issuer residing in Norway seeks admission to trading on a regulated market in another EEA state and the prospectus requires approval pursuant to the provisions of section 7-7 of the Securities Trading Act of 2007.

Section 7-4 number 8 of the Securities Trading Act of 2007 states that the provision of section 7-2 does not apply where the offer is addressed to professional investors pursuant to further rules laid down by the ministry in regulations.

What are the main exchanges available?

There are two equity markets in Norway. Oslo Børs (Oslo Exchange Market) is the only regulated market for securities trading. For companies that do not meet the requirements of the Oslo Exchange Market, there are is another licensed and regulated market called Oslo Axess. There are also unregulated and multilateral trading facility (MTF) marketplaces such as Merkur Market, Oslo Connect and Nordic ABM.

Is there a private placement market?

There is a private placement market in Norway. Private placements are popular where the prospectus rules do not need to be complied with.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document may give rise to both civil and criminal liability under Norwegian law. Norway has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

Debt security terms and conditions typically confer significant discretions on the trustee. The trustee will represent the interests of the debt security holders, and will be the only party who can take legal action, whether against the issuer's board of directors or the issuer itself. The conditions also provide for meetings of investors to consider matters affecting the investors' interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds
**Are there any restrictions on establishing a fund?**

Yes.

Establishing a fund or the fund management and marketing of units in funds towards the public, among other things, are regulated activities under the Securities Fund Act of 2011 or the Alternative Investment Fund Managers Act of 2014 and therefore subject to supervision by the Norwegian Financial Supervision Authority.

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**What are common fund structures?**

Common forms of funds include:

- Securities Funds (open-ended and closed-ended funds as well as fund-in-fund structures);
- National Funds (Norwegian fund structure according to chapter 6 in the Securities Fund Act of 2011);
- Special Funds (Norwegian fund structure according to chapter 7 in the Securities Fund Act of 2011);
- Undertakings for Collective Investments In Transferrable Securities (UCITS);
- Hedge funds, private equity funds, investment companies and real estate funds (Alternative Investment Funds (AIFs)); and
- Exchange-Traded Funds listed on the Oslo Stock Exchange.

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**What are the differences between offering fund securities to professional / institutional or other investors?**

**Retail funds**

Retail funds, including Undertakings for Collective Investments in Transferrable Securities (UCITS), are subject to a strict regulatory regime, including obligations with regard to the fund management and the investments of the securities fund's assets (ie allocation and investment limits and requirements as to liquidity of the investments). Special investor protection rules apply and it is required to provide key investor information and meet language requirements.

The retail funds are offered to non-professional investors and are subject to strict investor protection rules. Note that certain categories of funds cannot be offered to non-professional investors. A non-professional investor means any investor not considered as a professional investor, or one who may upon request be treated as such.

**Institutional/professional funds**

Professional funds are offered to professional investors and a professional client who meets two of the following three criteria: a total balance sheet of €20 million, turnover of €40 million or own capital of €2 million. In practice, in Norway, this often refers to non-UCITS funds, being hedge funds, private equity funds, investment companies and real estate funds, which fall into the category of Alternative Investment Funds (AIFs) and are therefore subject to the Alternative Investment Funds Managers Act of 2014. The regulatory framework is better suited for professional investors and does not set the same restrictions on the investments made by the fund.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

In general, the legal framework for establishing fund structures is complex and there are many risks to be taken into account.
A new entrant to the fund market will need to obtain the necessary license(s) from the regulator and set up an organization (incl. control bodies) which fulfills various suitability requirements. It will also have to manage the fund in compliance with the applicable regulations. The marketing and distribution of fund products to the public are subject to particular rules (for more information, see Establishing and investing in debt and hedge funds – establishment). It is also important for the fund incorporator to select the optimal fund structure to fit the fund product(s) intended for sale and the targeted fund investors.

For investors there are a lot of risk factors to take into consideration and an investment fund can generally reduce the risk of being exposed to a single security as it allows them to invest in a portfolio of securities, meaning a drop in the value of a single investment will not necessarily cause the value of the whole investment to collapse. That being said, all investments carry a varying degree of risk and investing in funds involves many of the same risks as any other investment. The value of an investment may rise or fall and the previous performance of a fund is not a guarantee of its future performance. Further, return and risk almost always go hand in hand; generally, an investor must take a greater risk to achieve greater returns. The risks that apply will often be determined by the classes of assets that the fund invests in and the selection of investments that the manager makes. Other risk factors that may impact on the performance of a fund include market risk, regulatory, economic and political risks (especially if the fund invests in non-EU markets, emerging markets etc), counterparty risk (if a counterparty defaults, that may impact on the fund's position), currency risk and gearing risks (if the fund borrows or utilizes derivatives to increase potential returns), diversification risk and liquidity risk. Liquidity risk is the risk that positions cannot be realized at a particular point in time both in relation to the manager's ability to buy and sell positions for the fund and the investor's ability to buy or sell units in the fund. The fund investor should carefully consider the fund's risk profile and the policies employed by the fund. Note that all risk indicators are usually based on historical data or assumptions.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Yes.

The units of a fund can be marketed by investment firms, licensed alternative investment fund managers or securities funds as well as banks to a certain extent. Other regulated entities may also be entitled to market units in a fund in cooperation with the manager.

The Securities Fund Act of 2011 and the Alternative Investment Fund Managers Act of 2014 set out the marketing regimes applicable for funds. They also provide exemptions for some of these marketing requirements where marketing is aimed at professional investors. In addition, the laws differentiate between securities' funds and alternative investment funds (AIF). AIFs are more suited for professional investors, therefore there are restrictions in relation to the marketing of such funds to non-professional investors. Where the AIF fund is marketed to professionals and it is below certain set fund thresholds, then a marketing permit from the Norwegian Financial Supervisory Authority is not needed. Where marketing is done towards non-professional investors, then the management is required to apply for a special marketing license.

The Undertakings for Collective Investments in Transferrable Securities (UCITS) directive has been incorporated into Norwegian legislation. This enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other. A UCITS intending to market in another member state must complete and submit to its home regulator a notification which must include certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Are there any restrictions on managing a fund?

The Securities Funds Act of 2011 and its related regulations set several requirements in relation to management of funds. The Norwegian Financial Supervisory Authority oversees and provides licensing for all securities fund management companies. To receive such authorization, certain statutory requirements must be met, and various restrictions arise on manager structuring, investment limits, organization of the activity, risk management etc. This Act also incorporates specific regulations regarding UCITS, incorporating the UCITS directive. Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive (as implemented in Norway).
Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Yes.

Investment services provided on a professional basis must be provided by undertakings authorized to do so by the Ministry of Finance. The authorization shall indicate which investment services and ancillary services the investment firm may provide. An investment firm shall apply to the Norwegian Financial Supervisory Authority for approval before it offers ancillary services beyond those indicated by the authorization. However, the following entities are exempted from the authorization requirement:

- the Central Bank of Norway;
- the National Insurance Scheme Fund;
- public authorities that manage public debt;
- management companies for securities funds;
- insurance companies;
- pension funds;
- depositories of securities funds, pension funds and alternative investment funds;
- undertakings authorized to operate as an options clearing house, clearing house or regulated market; and
- managers of alternative investment funds.

What are common types of derivatives?

Common types of derivatives include options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivative instruments, financial indices or financial measures which may be settled physically or in cash, commodity derivatives, credit derivatives and financial contracts for differences.

Are there any other notable risks or issues around entering into derivatives contracts?

In order to ensure close out netting, the derivatives agreements must be in writing and provide for valuations at market prices. In addition the derivatives must be of the kind described in the Norwegian Securities Trading Act 2007.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending
Lending is a regulated activity, and unless the available exemptions apply, a lender will need to be authorized by the Norwegian Financial Supervisory Authority (FSA) to conduct such business. There are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis; and
- to deal with borrowers who fall behind with their payments.

Foreign lenders may conduct business in Norway by establishing Norwegian subsidiaries and having these apply for authorization from the FSA. Special rules apply for entities that are authorized and seated in another European Economic Area state. Such entities may conduct business in Norway by passporting their licenses to Norway or through a branch.

Norwegian company law contains restrictions as to financial assistance. Section 8-7 of both the Private Limited Liability Companies Act of 1997 and the Public Limited Liability Companies Act of 1997 limit a Norwegian limited liability company's ability to grant credit for the benefit of its shareholder or a party closely related to a shareholder, or for the benefit of a shareholder of another company in the same group or any of its closely related entities. Such credit may only be granted:

- within the limits of the assets which the company may legally use for distribution of dividends (free equity); and
- if adequate security is furnished for the claim for repayment or recovery or within companies in the same group of companies.

There are certain exceptions to the rule mentioned above. The following credit may be granted outside the limits of the assets which the company may legally use for dividends:

- credit of customary duration in connection with commercial agreements;
- credit or security for the benefit of the parent company or other group company; and
- credit or security in favor of a legal person that has a controlling interest as set out in section 1-3 over the company, or in favor of a subsidiary of such a legal person, provided that the credit or security serves the group's economic interests.

Note that the requirement concerning adequate security shall not apply if the legal person is a state, municipality or county municipality.

Section 8-10 of both the Private Limited Liability Companies Act and the Public Limited Liability Companies Act limit a Norwegian limited liability company's ability to provide financial assistance or security in connection with the acquisition of shares in that company or any of its holding companies.

**Borrowing**

Borrowing is generally not regulated in Norway.

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**What are common lending structures?**

Lending in Norway can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties, are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one participant in the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

**Loan durations**
The duration of a loan can vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable, and often attracting a higher margin.

### Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see [Giving and taking guarantees and security](#).

### Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

### Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective. The Financial Contracts Act of 1999 chapter 3 contains several provisions that aim to protect consumers.

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**Do the laws recognize the principles of agency and trusts?**

The concept of a trust is not recognized under Norwegian law. However, the agency function is widely used and generally accepted under Norwegian law.

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**Are there any other notable risks or issues around lending?**

**Generally**

Loan agreements and other finance documents are subject to general contractual principles under Norwegian law, such as principles of revision of unfair contract terms. Certain statutory rules applying to financial institutions may also have implications to a lender, such as the mandatory requirement to include a maximum liability for a security interest or guarantee in order to ensure its validity if that security interest or guarantee is given in favor of a financial institution (other than in respect of security provided for the borrower's own debt).

**Specific types of lending**

Norwegian law poses certain challenges in the context of project finance and certain other types of asset lending transactions as security
cannot as a general rule be granted over contracts as such (only monetary claims arising under a contract), requiring careful structuring of these types of transactions.

**Standard form documentation**

Most Norwegian law syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA), but adapted for the Nordic market excluding or reducing the scope of a number of provisions in the standard template. Bilateral finance transactions are sometimes made using a simplified form of the LMA standard, but will most often be documented on bank standard form documentation prepared in-house.

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**Are there any other notable risks or issues around borrowing?**

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and to postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

The BRRD is under consideration by the Ministry of Finance, but has not yet been implemented into Norwegian law and no deadline has been set as of today. However, Norway already has rules with effects similar to BRRD.

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**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**

**Guarantees**

Guarantees are extensively used in Norway, and can be considered as a highly heterogeneous instrument. Guarantees may be issued by both private individuals/companies, credit institutions and public entities. They may guarantee both existing and future liabilities. The underlying claim may be a claim for money, contribution in kind or performance. Norwegian law recognizes the concept of on-demand guarantees. Recent court practice suggests, however, that careful structuring of on-demand instruments will be required to ensure their enforceability.

In the event that the guarantee is provided by a consumer in favor of a finance institution as the beneficiary, certain mandatory rules set out in the Financial Contracts Act of 1999 will apply. These rules contain:

- certain information requirements applicable to the beneficiary before entry into the guarantee;
- an obligation to dissuade the guarantor (if required);
- requirements in respect of the specific content of the guarantee document (eg information on the maximum guaranteed amount);
- certain notification requirements of the beneficiary (eg when security is not furnished as premised, in the event of default and deferral of payment); and
- restrictions in respect of when the guarantee may be enforced (The beneficiary may not make a claim against the guarantor until legal steps have been initiated to obtain a basis for enforcement against the principal. As a result of this, a consumer may not grant a traditional on-demand guarantee or an unconditional guarantee where the beneficiary is a financial institution.).
The same rules are applicable for non-consumer guarantees where the beneficiary is a financial institution (regardless of the type of guarantee provided). However, most of these rules are non-mandatory and routinely waived in guarantee agreements.

The guarantee must:

- be entered into in writing;
- contain details of the size of the maximum guaranteed amount; and
- contain information in respect of mortgages or other security for the beneficiary's claim, whether the guarantee shall encompass older debt, and, if so, whether the principal has defaulted on such debt, as well as other circumstances which the guarantor in accordance with honesty and good faith is entitled to be informed of.

General rules in respect of contractual invalidating factors also apply to guarantees and securities.

Note also that Norwegian company law contains financial assistance restrictions. Section 8-7 of both the Private Limited Liability Companies Act of 1997 and the Public Limited Liability Companies Act of 1997 (together the Limited Liability Companies Acts) limit a Norwegian limited liability company's right to grant credit and security (including guarantees) for the benefit of its shareholder or a party closely related to a shareholder or for the benefit of a shareholder of another company in the same group or any of its closely related entities. Such guarantees may only be granted:

- within the limits of the assets which the company may legally use for distribution of dividends (free equity); and
- only if adequate security is furnished for the claim for repayment or recovery.

The restrictions described above apply to a company's right to issue security for the benefit of a member of the board of directors, general manager or a member of the corporate assembly of the company or another company within the same group of companies, or any of their related parties, with certain exceptions in respect of issuing security for the benefit of employees.

There are, however, certain other important exceptions from the restrictions discussed above where:

- the security is of customary duration in connection with commercial agreements;
- the security is provided for the benefit of the parent company or another company within the same (Norwegian) company group;
- the security is granted in favor of a legal person that has controlling interest over the company, or in favor of a subsidiary of such legal person, provided that the credit or security shall serve the group's economic interests; or
- the security is granted for the benefit of a shareholder (owning less than 5% of the share capital in private companies and less than 1% in public companies) or related parties when the debtor is employed with the company or another company of the same group, such employment is his main occupation and the security is granted in accordance with customary rules for financial assistance to employees.

Pursuant to section 8-10 of the Limited Liability Companies Acts, a company may only provide security (hereunder provision of a guarantee) in connection with a third party's acquisition of shares or a right to shares in the company or the company's parent company within the scope of the funds that the company may use for distributing dividend and only if certain formal requirements are met, such as approval from the general meeting with 2/3 majority and satisfactory security for the recourse claim.

Exceptions to this restriction may be granted by regulations or individual decisions made by the King.

A transaction in violation of the financial assistance restriction is null and void, however, such invalidity may not be asserted against a counterparty in good faith. In extreme cases, a violation of the financial assistance restrictions may lead to criminal charges.

As guarantees are frequently granted from one company on behalf of other companies in the same group, the formal procedures set out in section 3-8 of the Limited Liability Companies Acts are of relevance. As a general rule, agreements between a company and its shareholders, the parent of the company's shareholders, or a person closely related to these, will not be binding upon the company unless the agreement is approved by a shareholders' meeting of the company.

In addition to this, there are also further formalities which must be complied with, such as:

- the requirement of a formal statement from the board of directors containing, inter alia, a declaration that the compensation that the company receives by providing the guarantee corresponds reasonably with the value of providing the guarantee (and a confirmation...
from the company's auditor regarding the same); and

- registration of the transaction in the Norwegian Register of Business Enterprises.

There are certain important exceptions from the main rule, such as agreements that are entered into in the course of the ordinary business of the guarantor on customary terms and conditions (eg cash pooling arrangements), agreements where the guarantor's consideration has a real value below 1/10 of its share capital (1/20 for public companies) and guarantees issued by a guarantor which is a 100% owned subsidiary of the legal person in favor of whom the security is granted, provided, however, that the security is given to serve the group's financial interests.

The main risk of non-compliance with section 3-8 is that the agreement (ie the guarantee) may be deemed void and not binding on the company, and any performance according to such an agreement shall be returned.

Pursuant to section 3-9 of the Limited Liability Companies Acts, transactions between companies of the same group shall be based on customary business terms and principles. To the extent that the value of the benefit/payment received by a Norwegian limited liability company in providing a guarantee does not correspond with the value of contribution provided by the company, such transactions may also be considered illegal distribution of dividends pursuant to the Limited Liability Companies Acts section 3-6. The consequence of an illegal distribution is that the distribution must be reversed, ie the guarantee will be invalid (with a reservation for a receiving party in good faith). An illegal contribution may also be subject to claims for compensation for loss or criminal sanctions.

It should be noted that even though interest expenses, as a general rule, are tax deductible, certain limitations apply to interest relating to intra-group loans, and guarantees and security granted in favor of a closely related entity.

Security

By agreement, a mortgage may be validly created only where authorized by the Mortgage/Liens Act of 1980 or other statute. In addition, a mortgage may not be validly attached as a whole to all the present and future property of the mortgagee.

When a right cannot be assigned, or can be assigned only on certain conditions, the same limitation applies in respect of attaching a lien to the right. However, one may always pledge the shares in a limited liability company unless the contrary is stipulated in the company's articles of association.

If a person owns only parts of an asset, this part may be pledged, but only if it is pledged in its entirety (ie if the person owns 50% of a property, then the entire 50% must be pledged).

A mortgage must set out the maximum amount (in Norwegian Krone, or in foreign currency for which a stock exchange rate is normally quoted in Norway) secured by such mortgage and is perfected by registration in a register of real property or in the movable property register.

Please see the rest of this answer in respect of guarantee limitations for further restrictions that apply equally to taking security.

What are common types of guarantees and security?

Common forms of guarantees

Under Norwegian law, guarantees have traditionally been classified into three main categories;

- conditional guarantees (simpel garanti);
- unconditional guarantees or sureties (selvskyldnerkausjon); and
- on-demand guarantees (påkravsgaranti).

There are also other types of guarantee which lie between these guarantees and where the degree of independence between the guarantee and the underlying obligation varies. Each guarantee must be assessed and interpreted in accordance with its specific content/wording.

Common forms of security
In Norway, security may not be validly attached as a whole to all the present and future property of the mortgagee.

Norwegian law states that security may be established in *inter alia* these forms and objects:

- Ownership and special rights in real property or unspecified parts of real property (including property comprised of the mortgage on a lease of land and houses thereon, mortgage of an owner section and leases of dwelling) may be mortgaged.
- Possessory liens may be created by agreement on movables that cannot be entered in a real property register.
- Liens on movables that can be entered in a real property register and accessories of such movables acquiring legal protection by being entered in the proper register.
- Business enterprises may create non-possessory liens on operating assets (*driftstilbehør*) that are used in or are designed for their business operations (such liens are created together with liens on ownership of or a registered and assignable right to use the real property to which the business relates).
- Business enterprises may create non-possessory liens – combined or individual – on motor vehicles that are used or intended for use in the business operation, and mobile construction machines that are used or intended for use in the enterprise's contractor business.
- Movables that are used or intended for use in agriculture operations but which are not accessories to real property and goods that are produced in the operations, can be separately attached with non-possessory liens.
- Movables that are used or intended for use in commercial operations conducted from fishing, whaling or sealing vessels, but which are not accessories of a vessel, may be separately attached with non-possessory liens.
- Business enterprises may create non-possessory liens on their stocks of goods used in the business (*varelager*).
- In connection with the sale of movable objects, a lien may by agreement be imposed on said objects as security for the seller's claim on the purchase price with the addition of interests and costs, or loans which a third party has granted to the buyer for full or partial payment of claims and which the lender has paid out directly to the seller.
- Securities, such as negotiable promissory notes and similar documents, share certificates and life policies, may be attached with possessory liens.
- A claim or a right evidenced by a redemption paper which is not a security may be attached with liens.
- Shares that are not registered in a securities register may be pledged unless the contrary is stated in the company's articles of association.
- Non-negotiable monetary claims on a named debtor may be attached with liens, as may non-negotiable money claims that will arise against a named debtor in a specifically mentioned legal situation.
- A business enterprise may conclude an agreement to assign, assign for security purposes or attach the non-negotiable money claims which it has or acquires in its business or a specific part thereof. It is not necessary that the debtors are named.
- Some authorizations may be pledged (see for instance section 20 of the Aquaculture Act (*Akvakulturloven*) and section 6-2 of the Petroleum Act (*Petroleumsloven*)).
- Vessels and aircraft may be pledged.

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**Are there any other notable risks or issues around giving and taking guarantees and security?**

**Giving or taking guarantees**

In a judgment from 2012 (Rt. 2012 s. 1267), the Norwegian Supreme Court concluded that a payment guarantee was not an on-demand guarantee, but a surety only, under which the guarantor could invoke debtor objections to the payment obligations, despite the fact that the guarantee included language customarily used in on-demand guarantees in the international business arena.

The case considered a guarantee that had been written in English. The dispute centered on the nature of the guarantee; the guarantor
claimed it was an on-demand guarantee, whereas the debtor claimed it was meant to be seen as a surety only. The guarantee did not say explicitly what kind of guarantee it was but contained some wording often found in on-demand guarantees, ie ‘irrevocably and unconditionally guarantee’, ‘as their own debt’, ‘immediately due on first demand’, and ‘honored forthwith’. The Supreme Court held that it had to look at the guarantee as a whole and that, on this basis, the guarantee left doubt as to whether it was a surety or an on-demand guarantee, and that such doubt should dis-benefit the party who had drafted it. The effect of this judgment is that, under Norwegian law, there are stricter requirements as to the contents of an on-demand guarantee in order to obtain the intended legal effect of such a guarantee, compared to what seems to have been the general assumption among practitioners and legal authors. It is therefore important to ensure that on-demand guarantees are drafted using language which removes any doubt as to their classification and legal effects, ie by saying explicitly that it is in fact meant to be an on-demand guarantee.

Giving or taking security

Pursuant to section 3-1 of the Partnerships Act of 1985, a limited partnership may not acquire its own shares, and cannot by agreement establish a security in its own shares. A subsidiary may not obtain shares in the parent company or by agreement establish a security in such shares. Any agreement to the contrary will be void. In addition to this, section 3-5 of the Partnership Act of 1985 stipulates that the partnership's right to receive capital cannot be assigned, nor can it be deposited as security for debt or subjected to distrain for the obligations of the partnership.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Financial Institution Act (Finansforetaksloven) 2015

Consumer credit

Financial Contracts Act (Finansavtaleloven) 1999

Corporations

Partnerships Act (Selskapsloven) 1985
Private Limited Liability Companies Act (Aksjeloven) 1997
Public Limited Liability Companies Act (Allmennaksjeloven) 1997

Funds and platforms

Alternative Investment Fund Managers Act (AIF-loven) 2014
Securities Fund Act (Verdipapirfondloven) 2011

Mortgages

Mortgage/Liens Act (Panteloven) 1980

Other key market legislation

Money Laundering Act (Hvitvaskingsloven) 2009
Securities Trading Act (Verdipapirhandelovden) 2007
Stock Exchange Act (Børsloven) 2007
Financial Collateral Act (Lov om finansiell sikkerhetsstillelse) 2004
Enforcement Act (Tvangsfullbyrdelsesloven) 1992

Regulatory authorization

Who are the regulators?

The Norwegian Financial Supervisory Authority (Finanstilsynet) (the FSA) is responsible for the supervision and follow-up of banks, finance companies, mortgage companies, insurance companies, pension funds, investment firms, securities fund management and market conduct in the securities market, stock exchanges and authorized market places, settlement centers and securities registers, estate agencies, debt collection agencies, external accountants and auditors. Finanstilsynet is an independent government agency that builds on laws and decisions emanating from the Parliament (Stortinget), the Government and the Ministry of Finance (Finansdepartementet) and on international standards for financial supervision and regulation.

The Norwegian Ministry of Finance is responsible for planning and implementing Norwegian economic policy and for coordinating the work with the Fiscal Budget. The Ministry of Finance is the complaints body for the FSA.

What are the authorization requirements and process?

Depending on the type of firm, a firm must apply to the Norwegian Financial Supervisory Authority (Finanstilsynet) (FSA) or the Norwegian Ministry of Finance for authorization.

The regulators must assess whether the application meets the required threshold conditions within six months of the submission of the complete application.

The application fee depends on the type of the application.

The regulator will also approve key individuals in their roles.

Authorized firms and individuals are registered on the Authorization Register (Konsesjonsregisteret), which is provided by the FSA online on their home page.

What are the main ongoing compliance requirements?

The firm must have started its business within one year from the day the authorization was granted, and must still be active. Threshold conditions (such as fulfilling the governance and capital requirements as well as being compliant with the terms of the authorization) are an ongoing compliance requirement for authorized firms.

Failure to comply with the capital requirements and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and loss of authorization.

What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment.
Regulated activities

What finance and investment activities require authorization?

Financial activities may only be conducted by authorized banks, credit institutions and finance undertakings. When stipulated in the Financial Institution Act 2015 chapter 5, foreign credit institutions may also ‘passport’ their and/or conduct financial activities in/to Norway.

‘Financial Activities’ means the granting, intermediating or furnishing of guarantees for credit or otherwise participating in the financing of activity other than one's own, except for:

- business related to public institutions or a fund that is intended for special credit purposes;
- business conducted by a foundation that does not have as its purpose to conduct business activities, or the county administrator’s management of financial assets pursuant to the act on custody (Vergemålsloven);
- credit or guarantees provided on behalf of the company's or the group's employees;
- credit provided by the seller of a good or service;
- business conducted as a financial agent or a financial advisor; or
- financial services that are conducted only in isolated cases.

Examples of finance and business activities that require authorization include banks, credit institutions, finance undertakings, payment institutions, electronic money institutions, insurance companies, life insurance companies, general insurance companies, credit insurance companies, pension funds and loan intermediaries.

Are there any possible exemptions?

Yes.

‘Financial Activities’ that are exempt include:

- business related to public institutions or a fund that is intended for special credit purposes;
- business conducted by a foundation that does not have as its purpose to conduct business activities, or the county administrator’s management of financial assets pursuant to the act on custody (Vergemålsloven);
- credit or guarantees provided on behalf of the company’s or the group’s employees;
- credit provided by the seller of a good or service;
- business conducted as a financial agent or a financial advisor; or
- financial services that are conducted only in isolated cases.

Do any exchange controls or other restrictions on payments apply?

Norway does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in and out of the country.

Note, however, that there may be anti-money laundering and tax considerations to take into account.
What are the rules around financial promotions?

The Marketing Control Act 2009

Where financial products or services are marketed to consumers in particular, but also to a small extent to businesses, the Marketing Control Act of 2009 will apply unless otherwise stated. This Act and related regulations contain rules aimed at protecting consumers, by ensuring for example that the total price of products or services are clear and unambiguous, and also that the seller does not use misleading communications or omit to inform of important details regarding the services or products.

The Financial Contracts Act of 1999 applies to contracts and assignments concerning financial services with financial institutions or similar institutions, unless otherwise provided by or pursuant to law. This Act regulates specifically what information must be provided to consumers when marketing loan and credit agreements.

In addition, the Consumer Ombudsman has provided extensive guidelines in relation to marketing of specific financial products aimed towards consumers, for example credit cards. There are also certain market standards or agreements established in Norway that set requirements for promotions of certain financial products, which can also secure fair comparisons of these.

Where transferable securities are being offered, a prospectus may be required, and these rules will provide more detailed information regarding how such securities can be promoted.

The Financial Institution Act 2015

The Financial Institution Act of 2015, chapter 2 part III says that banks need to use the word ‘bank’ in their company name. The same rule applies to sparebanker. No entities other than banks and sparebanks may use such wording. Similar rules apply in the case of insurance companies.

Rules relating to a financial institution’s relationship to customers and related financial promotions are set out in chapter 16 of the Financial Institution Act 2015.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities that are used to undertake financial or investment activity (ie banks, pension funds, credit institutions etc) are limited liability companies (aksjeselskap) (denoted by the suffix AS), public limited liability companies (allmennaksjeselskap) (denoted by the suffix ASA) and Norwegian savings banks (sparebank).

Funds

Investment funds and fund managers are limited liability companies, public limited liability companies, or similar foreign companies.

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

Foreign lenders may conduct business in Norway by establishing Norwegian representative offices (NUF) subsidiaries and have these apply for authorization from the Norwegian Financial Supervisory Authority. Credit institutions, insurance companies, pension funds,
payment institutions and electronic money institutions that are seated and authorized in another European Economic Area state may passport the licenses from their home jurisdiction to Norway and conduct business in Norway without getting a separate license here.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform, rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is still in its early days in Norway and we only see a few platforms in the market. The main obstacle for growth in the Norwegian market is most likely to be the regulatory regime, which is quite demanding.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P) type structures, often operated through an electronic platform provider as well as crowdfunding. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds, as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain, in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust
to operate as a store of value (e.g., in the case of cryptocurrencies such as bitcoin) or providing an indisputable record, for example, relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe, and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**What is a cryptocurrency?**

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether, based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing, and exchanging currency).

**Initial coin offerings and token-based products**

**What is an initial coin offering (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture. ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights; and
- compliance with law and all regulatory requirements.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.
Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet, rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Norwegian Financial Supervisory Authority (Finanstilsynet or FSA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets.

GENERAL

A person must not carry on a regulated activity in Norway unless authorized or exempt (known as the general prohibition). A financial activity requires regulatory authorization when: it is identified as a specified activity, it is carried on by way of business in Norway and it does not fall within any of the available exemptions. Where FinTech products and/or applications involve financial activity which requires regulatory authorization, the firms providing such products and/or applications must be authorized by the FSA.

POINT OF CONTACT AT THE FSA

The Norwegian Ministry of Finance has proposed to establish a contact point at the FSA for guidance of FinTech companies. The Ministry of Finance believes that the emergence of new players, new technologies and new business models creates the need for guidance and clarifications in areas where current rules are based on well-known business models and methods of production. The proposal is currently under assessment at the FSA.

Electronic payments platforms and regulation of peer-to-peer lenders

The emergence of new entrants, who are using technology to provide financial services in new ways can be seen in Norway. The rise of FinTech as a separate industry also reflects a change in the way that the supply-side is interfacing with customers in Norwegian markets. For example, in the payment services and financing segments, new players are entering the market and offering financial services outside the established financial system, at the same time as financial undertakings are developing competing services within the system.

ELECTRONIC PAYMENT PLATFORMS

A number of FinTech businesses are offering electronic payment platforms to rival the traditional payment systems and the introduction of new regulations recognizes the rise in such businesses, with the aim of creating a more level playing field for payment services providers, while addressing the need for enhanced security and customer protection.

All participants in a payment system will be regulated by the Norwegian Financial Institutions Act of 2015 (Finansforetaksloven or Financial Institutions Act), if the participant is deemed to perform payments services.

E-MONEY

The Financial Institutions Act regulates e-money institutions and issuance of e-money. E-money is defined as electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person other than the electronic money issuer and include pre-paid cards and electronic pre-paid accounts for use online. Firms issuing e-money must be authorized with the FSA.

PEER-TO-PEER LENDERS
Lending is a regulated activity in Norway, and unless any exemptions apply, a lender will need to be authorized by the FSA to conduct such business.

Businesses conducting brokerage of loans must notify the FSA of their business. Loan brokers are subject to certain requirements in the Financial Institutions Act and is, among other things, obligated to give the lenders and borrowers information concerning the terms and conditions of the loans.

**Regulation of payment services**

Where a Norwegian business provides payment services, as a regular occupation or business activity in Norway, it will require authorization by the FSA to become an authorized payment institution under the Financial Institutions Act. Failure to obtain the required authorization is a criminal offence.

In order to become authorized by the FSA, a payment services business will need to meet certain criteria, including, in relation to its business plan, initial capital, processes and procedures in place for safeguarding client funds, sensitive data and money laundering and other financial crime controls.

There is ongoing legislative work in Norway with a new Financial Contracts Act (Finansavtalelov). The new law will among other European Union regulations, implement the European Union Payment Services Directive II.

**Application of data protection and consumer laws**

The Norwegian Data Protection Act 2000 (Personopplysningsloven or DPA) regulates the processing of personal data in Norway. The DPA implements the European Data Protection Directive of 1995. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the DPA and have certain notification and compliance obligations.

The European General Data Protection Regulation (GDPR) is due to replace the DPA from 25 May 2018. It is proposed that a new data protection act will therefore replace the existing DPA. The GDPR introduces some new obligations and is more specific than the current DPA on certain issues, including mandatory notifications where a breach occurs and provide for severe monetary sanctions for breach.

The Norwegian Marketing Act 2009 (Markedsføringsloven or Marketing Act) regulates unsolicited direct marketing by electronic means and other special categories of marketing. The proposal for a new Regulation on Privacy and Electronic Communications by the European Commission is, however, expected to lead to amendments to the Marketing Act, if the regulation is implemented in Norway.

**Money laundering regulations**

The Norwegian Act on Money Laundering and Terrorist Financing (Hvitvaskingsloven) imposes certain obligations on financial institutions and others who perform services on their behalf, such as credit institutions, investment firms and payment service providers. The obligations generally include customer due diligence and a duty to report suspicious activities, and are intended to prevent money laundering and terrorist financing.

New anti-money laundering legislation, based on the European Union’s Fourth Money Laundering Directive, is currently under development and a revised act is expected to be presented to the Norwegian parliament before the end of 2017. It is assumed that the new act will take greater account of the new service providers created through the development of FinTech. The FSA is responsible for supervising entities’ adherence, under both current and future legislation.

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**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. An example is the FintechAngels at TheFactory. Such seed investment is often
used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

Crowdfunding has also been introduced in the Norwegian market. This type of funding may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

The Norwegian market has primarily reward-based crowdfunding, which provides investors with a tangible benefit, such as early access to a platform or an application that the business is developing.

ACCELERATORS

There are various incubators or accelerators in the Norwegian market which offer support, facilities and funding for startups, often in return for an equity stake. For example, TheFactory operates as an accelerator, incubator and mentor for FinTech companies and offers an investment up to NOK 350,000 in return for 5%-to-12% equity.

GOVERNMENT PROGRAMS

Innovation Norway (Innovasjon Norge) is the Norwegian Government’s most important instrument for innovation and development of Norwegian enterprises and industry. Innovation Norway supports companies in developing their competitive advantage and encouraging innovation. The organization also provides services for startup companies, such as mentoring and startup grants. More information can be found here.

Venture capital and debt

Venture capital funding is a type of equity investment, usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed, to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically offered as a convertible bond or loan.

Peer-to-peer platform funding

An alternative form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead interest is paid on the money borrowed. This is relatively new in the Norwegian market, but is anticipated that we will see more and more of this type of funding in the future.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Norway has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) is a popular funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the Oslo Stock Exchange (Oslo Børs).
Oslo Axess and Merkur Market provide alternatives to the Oslo Stock Exchange. Oslo Axess is a regulated market, suitable for companies that have less than three years of history and who seek a quality stamp and other benefits associated with listing on a regulated market. Merkur Market is a multilateral trading facility and an option for all types of companies, ranging from newly incorporated growth companies, to savings banks or mature industry companies, that do not satisfy the listing requirements, or do not wish to be fully listed on a regulated market.

**CONVERTIBLE BONDS/LOAN NOTES**

A popular funding tool for startup companies, including FinTech businesses, is to issue convertible bonds or loan notes, which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

**Incentives and reliefs**

SkatteFUNN R&D tax incentive scheme is an initiative designed to stimulate research and development (R&D) in Norwegian trade and industry. Businesses and enterprises that are subject to taxation in Norway are eligible to apply for SkatteFUNN.

The incentive is a tax credit and comes in the form of a possible deduction from a company’s payable corporate tax. Small and medium sized businesses that satisfy the relevant requirements can obtain tax relief in respect of up to 20% of their project costs, and larger businesses that satisfy the relevant requirements can obtain tax relief in respect of up to 18% of their project costs. More information about the SkatteFUNN R&D tax incentive scheme can be found [here](#).

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**Portfolio sales**

**Loan transfers and portfolio sales**

*What are common ways of buying and selling loans?*

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

Loan transfers between professionals are commonly documented using standard form contracts made available by the Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

Note also that lending is a strictly regulated activity in Norway and that in principle assuming a creditor position as part of a loan sale and purchase process can trigger an authorization requirement (subject to any applicable exemptions).

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*What are the main considerations when transferring a loan and related security?*

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **Confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **Data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **Lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **Undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

Generally speaking, Norway has been reluctant to open up to the privatization of core infrastructure; and most transport infrastructure, the electricity grid and large hydropower production assets are publicly owned. Telecoms infrastructure, apart from the emergency network is generally privately owned and operated. Whilst ownership may be private, owning and/or operating relevant infrastructure will in most cases be subject to authorizations and government concessions.

Energy

There are no restrictions on private ownership of energy assets, apart from 'large' hydropower assets (above 10MW) that must be at least two thirds publicly owned and controlled. Whilst ownership may be private, owning and/or operating relevant energy infrastructure will in most cases be subject to special authorizations and government concessions.

Statnett SF is the state-owned enterprise responsible for building and operating the central grid. Statnett SF is the transmission system operator (TSO) for the central grid and owns more than 90% of it.

The Ministry of Petroleum and Energy (MPE) has the overall responsibility for managing the energy and water resources in Norway. The MPE's job is to ensure that this management is carried out according to the guidelines provided by the Storting and the Government. The Ministry's Energy and Water Resources Department has ownership responsibility for Statnett SF.

The Norwegian Water Resources and Energy Directorate (NVE), which reports to the MPE, is responsible for managing domestic energy resources, and is also the national regulatory authority for the electricity sector. The NVE is also responsible for managing Norway's water resources.

The total length of the Norwegian gas pipeline network is about 8,300 kilometres. Most of the gas transport infrastructure is jointly owned through the partnership Gassled, while Gassco is the neutral and independent operator.

Gassled is a private joint venture that owns most of the gas infrastructure on and serving the Norwegian continental shelf (including pipelines, platforms, onshore processing plants and receiving terminals abroad).

The Norwegian gas transport infrastructure includes several receiving terminals in other countries. Norway and those countries where gas from the Norwegian shelf is landed have concluded agreements regulating their rights and obligations in this connection.

Telecoms infrastructure

Telecoms infrastructure, apart from the emergency network, is generally privately owned and operated.

The electronic communications sector in Norway is regulated through both sector-specific and general laws and regulations. Although not an EU member, Norway is required, as a member of the European Economic Area (EEA), to adhere to the EU’s regulatory framework to the extent that EU directives are adopted by the EEA pursuant to the Agreement on the European Economic Area. The Electronic Communication Act (the ECA) and regulations adopted pursuant to the ECA implement the EU regulatory framework for the electronic communications sector in Norway. The competent regulatory authority in Norway is the Norwegian Communications Authority.
Transport infrastructure such as road and rail networks (and related infrastructure) are publicly owned.

Norway has approximately 98 airports. Of these, 45 are owned by the government through its airport operator, Avinor. Airports used only for general aviation (GA) are owned by a mix of municipalities, aviation clubs and private companies.

Public (sea) ports are generally municipally owned, with limited private ownership interests in isolated instances.

The main governing body in respect of transport infrastructure is the Norwegian Ministry of Transport and Communications, which performs operations through numerous subsidiaries. Tasks related to public transport and some roads have been delegated to the counties and municipalities.

**Are there special rules for investing in energy and infrastructure?**

**Generally**

No, but the ownership and/or operation (or related activities) is generally subject to special authorizations and Government concessions.

**Energy**

Special regulations and restrictions apply to investments into 'large' hydropower assets (above 10MW).

**What is the applicable procurement process?**

**Generally**

Public procurement in Norway is governed by a set of rules that are meant to ensure fair competition, integrity and predictability in the procurement process, and the equal treatment of providers.

Norwegian legislation distinguishes between tender invitations for contracts above and below the European Economic Area (EEA) Public Procurement Thresholds. Above the EEA thresholds, Norway is obliged to follow the relevant EU regulations through the Agreement on the European Economic Area. Tender invitations for contracts above these thresholds are advertised in the English language in the EU official journal and the TED database.

Below the EEA thresholds, national rules govern the procurement process. These are in general simplified versions of the implemented EU regulations. In Norway there is also a national threshold of NOK 1.1 million. Invitations to tender for contracts above the national threshold must be made public in the Norwegian official database, Doffin. Under the national threshold, the employer is allowed to choose a procedure which ensures a minimum level of competition.

**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

The most common forms of funding for energy and infrastructure include balance sheet lending and project finance (including PPP).

**Investing**

The most common forms of investing in energy and infrastructure include direct equity investments.
Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the authorities consider that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

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What regulatory penalties may apply?

Where a breach has taken place, the Norwegian Financial Supervisory Authority or the Norwegian Ministry of Finance may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

In addition to this, ordinary penalties and sanctions may be imposed by the Norwegian police.

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What criminal penalties may apply?

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the Money Laundering Act of 2009; and
- conducting regulated activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Mortgages over Norwegian real estate must be registered at the Land Registry (Statens Kartverk) to ensure legal protection against third parties. The fee for such registration is NOK 525.

Mortgages granting security over moveable property (eg vehicles, capital assets, inventory) must be registered in the Register of Mortgaged Moveable Property (Løsøreregisteret) to ensure legal protection against third parties. The fee for such registration is NOK 1,051 when registered electronically and NOK 1,516 when registered on paper.
Mortgages granting security over aquaculture permits must be registered in the Register of Aquaculture (Akvakulturregisteret) to ensure legal protection against third parties. The fee for such registration is NOK 1,450.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?**

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security.

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**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

No.

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**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

No. There is no withholding tax on interest payments.

If so:
What is the rate of withholding?

N/A.

What are the key exemptions?

N/A.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

N/A.

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**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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Key contacts

Egil Hatling
Partner
Advokatfirma DLA Piper Norway DA
egil.hatling@dlapiper.com
T: +47 24 13 15 00
Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are certain restrictions on offering and selling debt securities under Peruvian law if those securities will be offered under a public offering.

A public offering of marketable securities is a public invitation to one or more individuals or legal entities of the general public, or specific segments thereof, to carry out a legal placement, acquisition or disposal of marketable securities.

The Securities Registry is where securities, securities issue program documentation, mutual funds, investment funds and participants in the securities market are registered, with the purpose of making the information thereon publicly available, allowing decision-making by investors and ensuring the market's transparency. The legal entities entered in this registry and the issuer of registered securities are obliged to submit the information required by law and other regulation and are accountable for the truthfulness of such information.

The publicly offered securities and securities issue programs documentation are required to be entered in the Securities Registry and no previous administrative authorization is required (except for, in the case of financial companies the previous authorization to be obtained from the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS)). The registration of securities that will not be offered publicly is optional.

The holders of debt securities may request the registration of such securities in the Securities Registry in accordance with the provisions of the applicable law and the terms established in the issuance agreement or, as the case may be, the equivalent instrument. If no regulation has been set forth on this regard, the request must be backed up by the holders of such securities that represent the absolute majority of the outstanding amount issued.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Peru are bonds or notes issued on a stand-alone basis or under a program. A debt security is any right of debt issued on a mass basis that is transferable to third parties.

Many different types of debt securities are offered in Peru. According to the Regulations on the Initial Public Offering of Marketable Securities (Reglamento de Oferta Pública Primaria y de Venta de Valores Mobiliarios) (Resolution Conasev 141-1998-EF/94.10) and SMV supplemented regulations (Normas Comunes para la Determinación del Contenido de los Documentos Informativos) (Resolution Conasev 211-98-EF/94.11), some common forms include:

- securities granted by common companies (commercial paper, issued for debt younger than a year, and corporative bonds, issued for debts older than a year); and
• securities granted exclusively by authorized financial companies:
  • negotiable corporative certificates of deposit (issued for debt younger than a year);
  • corporative bonds (issued for debt older than a year);
  • subordinate bonds (issued for subordinate debt that qualify as effective equity); and
  • leasing bonds (issued for financing the purchase of goods for leasing).

Additionally, the securities listed above must have any of the following characteristics to qualify as typical securities:
• zero coupon securities that pay a fixed amount at its maturity;
• periodical fixed-rate securities, with amounts and maturity determined at its issue;
• securities with automatic adjustment of the principal according to the General Act of the Financial and Insurance Systems and Internal Organization Act of the SBS; and
• variable-rate securities, in which the interest rate cannot be a rate (such as LIBOR, PRIME, or others) plus a fixed differential.

Non-typical securities, which are the ones that are not listed above but have the characteristics of a debt security (which are not common in Peruvian securities), which may have any of the following characteristics, include:
• guaranteed securities, perpetual debt securities (ie debt securities that have no specified redemption date);
• asset-backed securities;
• derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
• hybrid securities (securities with both debt and equity features);
• equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
• exchangeable bonds (debt securities convertible into the equity of a third party);
• depositary receipts (a security issued by a depositary conferring its holders beneficial ownership of certain underlying assets held by the depositary); and
• warrants (securities giving its holders the option to purchase the equity of the issuer or a related company).

**What are the differences between offering debt securities to institutional / professional or other investors?**

An offering that exclusively targets institutional investors is considered as a private offer and the regulations established in the Securities Act (Ley del Mercado de Valores) will not be applicable.

In that scenario, securities acquired by an institutional investor cannot be transferred to third parties, unless such third party is another institutional investor or the security is previously entered in the Securities Registry conducted by the Superintendence of Securities Market (SMV).

Nevertheless, institutional investors can decide whether to register before the Securities Registry under a special regime the following issues targeted to institutional investors: (i) the ones registered as such before the SMV; (ii) the ones registered before the U.S. Securities and Exchange Commission – SEC under Rule 144A or Regulation S of the U.S. Securities Act of 1933; (iii) the registered as such before other stock exchanges member of the Latin American Integrated Market (Mercado Integrado Latinoamericano – MILA).

**When is it necessary to prepare a prospectus?**
Unless an exemption applies, it is necessary to prepare, register and publish a prospectus before the Superintendence of Securities Market (SMV) where there is an initial public offering (IPO) of securities, ie the public offering of new securities.

Among other reasons, the prospectus is needed in order to have a security subject to the IPO entered in the Securities Registry. The basic requirements for the preparation of the prospectus are stated in the Regulations on the Initial Public Offering of Marketable Securities (Reglamento de Oferta Pública Primaria y de Venta de Valores Mobiliarios) (Resolution Conasev 141-1998-EF/94.10) and SMV supplemented regulations (Normas Comunes para la Determinación del Contenido de los Documentos Informativos) (Resolution Conasev 211-98-EF/94.1.1).

In addition, there are other special regimes that require lighter requirements.

An offer would not be deemed to have been made to the public if it is made solely to qualified investors or where the minimum denomination per unit is at least PEN499,908.28 in 2019 (equivalent to approximately US$147,770.70). The denomination per unit is annually adjusted.

The underwriting or acquisition of securities presupposes the acceptance by the underwriter of all terms and conditions of the offering, as they appear in the informative prospectus.

What are the main exchanges available?

The unique legal stock exchange in Peru is the Lima Stock Exchange (Bolsa de Valores de Lima S.A.), which is a corporation (sociedad anónima) that offers listed securities trading services and provides services, systems and mechanisms for the brokering of publicly offered securities and instruments. The company operates under the supervision of the Superintendence of Securities Market (SMV).

Since 30 May 2011, Lima Stock Exchange (Bolsa de Valores de Lima), Santiago Stock Exchange (Bolsa de Comercio de Santiago), Colombia Stock Exchange (Bolsa de Valores de Colombia) and the Mexican Stock Exchange (Bolsa Mexicana de Valores) (since June 2014) established an alliance namely the Latin American Integrated Market (Mercado Integrado Latinoamericano - MILA) in order to foster the trading activity in those markets by allowing the intervention and operation of investors and intermediaries in any of such stock markets.

Is there a private placement market?

Even though there are no official records, there is an active market for private placements. However, private pension funds – which are the principal investors in the Peruvian securities market – generally purchase securities that have information registered at the Superintendence of Securities Market (SMV).

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to administrative, civil and criminal liability under Peruvian law. Peru has various investor protection statutory provisions relevant to liability for inaccurate prospectus. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretion on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors' interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.
Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the following laws:

- **private pension funds** – regulated under the General Act of the Financial and Insurance Systems and Internal Organization Act of the Superintendency of Banking and Insurance (Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros) and its Regulations and therefore subject to the regulations of the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS);

- **investment funds** – regulated under the Investment Funds and their Management Companies Act and its Regulation and therefore subject to the regulation of the Superintendence of Securities Market (SMV);

- **mutual funds** – regulated under the Securities Market Act and its Regulations and therefore subject to the regulations of the SMV; and

- **collective funds** – regulated under the Collective Fund Act (A las Empresas Administradoras de Fondos Colectivos contralará SMV) – Executive Order 21907 and its Regulations and therefore subject to the regulations of the SMV.

An investment fund may be established through a general regime or a simplified regime.

All funds are subject to the general regime unless offers are:

- exclusively directed to institutional investors;
- directed to investors that will pay certain minimum quotas before the funds can operate; or
- directed to the management company's shareholders, directors and members of the 'Investment Committee'.

The incorporation of an investment fund under the simplified regime is automatically approved upon the submission of the required documentation. On the other hand, the incorporation of a fund under the general regime is subject to the approval and authorization of the SMV.

What are common fund structures?

Common forms of private pension funds include:

- **capital protection** – minimum investment 100% in debt securities (maximum 100% short term and 75% long term);

- **capital preservation** – maximum 10% in equity securities, maximum 100% in long-term debt securities; maximum 40% in short-term debt securities and maximum 10% in derivatives;

- **mixed or balanced** – maximum 45% in equity securities; maximum 75% in long-term debt securities; maximum 30% in short-term debt securities and maximum 20% in derivatives; and

- **capital growth** – maximum 80% in equity securities, maximum 70% in long-term debt securities, maximum 30% in short-term debt securities and maximum 30% in derivatives.

Common forms of investment fund include:

- investments in any kind of securities, deposits, participation certificates on mutual funds, properties, leasing over properties, factoring and bills discounting;

- open-ended and closed-ended funds;

- retail and non-retail funds (including mixed investment funds);
Undertakings for Collective Investments in Transferable Securities (UCITS) and non-UCITS funds; and qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

Common forms of mutual funds include:

- **debt securities mutual funds** – 100% in debt securities minimum, sub-classified in very short term, short term, middle term and long term;
- **moderate mixed mutual funds** – 75% in debt securities minimum and 25% equity maximum;
- **balanced mixed mutual funds** – 50% in debt securities and 25% in equity securities as minimum investment;
- **growing mixed mutual funds** – 50% in debt securities and 50% in equity securities as minimum investment;
- **equity mutual fund** – 75% in equity as minimum investment;
- **partial secured mutual fund** – 75% of its capital is secured;
- **fixed income secured mutual fund** – 100% of its capital is secured and a minimum income;
- **secured mutual fund** – 100% of its capital is secured;
- **structured mutual fund**;
- **international mutual fund** – 51% in overseas securities;
- **mutual fund of mutual funds** – 75% in other mutual funds; and
- **flexible mutual fund** – any other criteria than above.

Common forms collective funds include different groups for purchasing:

- properties and mortgage payments;
- cars and trucks;
- machinery and equipment;
- motorcycles, moto-taxi and household appliances; and
- educational services.

What are the differences between offering fund securities to professional / institutional or other investors?

For investment funds, the main difference is that if the fund's securities will be exclusively offered to institutional investors, the registration procedure of the funds will be conducted through the simplified regime. In that sense, the management company will not be obliged to present an advance copy of the agreement to be executed with its clients (which is needed for funds incorporated under the general regime) or require to register in advance the information regarding the investment fund and its issue.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

There are no specific risks to reference here other than those referred to in Establishing and investing in debt and hedge funds – establishment.
Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

No, there are no limits or restriction on marketing a fund, except for common law principles applicable to all services and products that are offered in the market. The marketing must be done directly by the Fund Management Company or an authorized promotor (such as a brokerage firm representative).

Are there any restrictions on managing a fund?

The Superintendence of Securities Market (SMV) is responsible for regulating and supervising funds. Fund managers, individuals and legal entities are prohibited from carrying on regulated activities, such as fund management, without authorization.

The SMV authorizes the organization and operation of a fund management company as a corporation (sociedad anónima) and supervises it as long as its purpose is to manage investment funds, mutual funds and collective funds. The Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) authorizes the organization and operation of private pension funds.

All fund management companies need an authorization except for investment fund management companies whose funds only issue trust certificates not to be placed through public offerings, which are not supervised by the SMV, being obliged to inform such condition to their investors and clients.

The capital of management companies is prescribed by law and varies for:

- private pension fund management companies;
- investment fund management companies and mutual fund management companies; and
- collective fund management companies.

Additionally, the net equity of any management company must be at least than 0.75% of the sum of mutual fund and investment fund equities under its administration.

Management companies must obtain a business license either from the SMV or the SBS. The conditions applicable to the establishment of a management company remain throughout the company's existence.

Management companies are required to grant certain guarantees on behalf of the SMV in order to guarantee the compliance of the obligations assumed before their investors.

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

There are no restrictions on entering into derivatives contracts as all of them are executed on an 'over-the-counter' (OTC) basis, which means that contracts are negotiated and agreed between private parties without being regulated.

Without prejudice to the foregoing, the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) establishes a limited amount of operations related to derivative contracts for financial entities in relation to their equity in order to regulate their total exposure and guarantee a diversified investment portfolio.
What are common types of derivatives?

Derivative contracts are executed in Peru for a range of reasons including hedging, trading and speculation.

All of the main types of derivative contracts are widely used in Peru:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets.

The main classes of underlying assets seen in Peru are:

- equity;
- fixed income instruments;
- commodities;
- foreign exchange; and
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

Considering that the market for derivative contracts in Peru is limited and that there is no regulation applicable to that type of operation, no notable risks are apparent other than the limitations established by the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) in relation to the level of exposure from authorized financial companies.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is only a regulated activity if it is conducted using public money (defined as deposits obtained from individuals). Under these circumstances, a lender will need to be authorized by the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) to conduct such business.

Financial operations conducted using public money are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular regulations relating to the provisions of corresponding loan agreements, including the amount to be lent and the total exposure that banks and financial entities should have for these types of loans.

Additionally, regulated credit agreements have specific requirements regarding drafting and forms and the information to be included therein.

In relation to the interest rates, through Circular Letter 018-2019-BCRP, the Central Reserve Bank of Peru established that financial system operations are determined by free competition in the financial market.
On the other hand, for individuals and companies that are not part of the financial system, the maximum conventional compensatory interest rate is mandatory as set forth in the Peruvian Civil Code and the Central Reserve Bank of Peru. The maximum conventional compensatory interest rate is established on a daily basis by reference to the average rate of the financial system for credits to be granted to small-companies (microempresas).

There are no additional restrictions applying to foreign lenders making loans to Peruvian borrowers.

**Borrowing**

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the above-mentioned protections.

**What are common lending structures?**

Lending in Peru may be structured in a number of different ways to include a variety of features and conditions depending on the commercial needs of the parties.

A loan may either be provided on a bilateral basis (a single lender providing the entire facility) or a syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

**Loan durations**

The duration of a loan may also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid; or
- an overdraft, provided on a short-term basis to solve short-term cash flow issues.

**Loan security**

A loan may either be secured, unsecured or guaranteed. These conditions depend on the risk profile of the borrower and the total amount to be lent, and the exposure of the effective equity of the lender, among others.

**Loan commitment**

A loan may also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

**Loan repayment**

A loan may also be repayable on demand, on an amortizing basis (in instalments over the loan life) or scheduled (usually meaning the loan is repayable in full at maturity).
What are the differences between lending to institutional/professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory supervision and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity. Standard contracts and loan documents forms must be previously approved by the SBS.

Do the laws recognize the principles of agency and trusts?

Peruvian law does not have any specific provisions about agency. Thus, any agency undertaken with Peruvian entities is governed by the provisions of any contract entered into between the parties.

Trust principles are recognized as a matter of Peruvian law and have specific regulations. For instance, it is possible to appoint a trustee (which must be subject to the supervision of the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS)) to hold rights and other assets on trust for lenders or secured parties.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. In addition, regulated companies are obliged to provide their clients, specially when they qualify as consumers, full and easy-to-understand information regarding the main conditions of the loans and credit facilities to be granted, being subject to penalties if those obligations are not fulfilled.

The administrative authorities in charge of attending consumers' complaints are the National Institute for the Defense of Free Competition and the Protection of Intellectual Property Rights (INDECOPI) and the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS).

Specific types of lending

There are different types of lending available depending on the purpose for which the money is borrowed and the characteristics of the debtor. According to prudential regulations, specifically the Regulations for the Assessment and Rating of the Debtor and the Requirement of Provisions (Reglamento para la Evaluación y Clasificación del Deudor y la Exigencia de Provisiones), Resolution SBS 11356-2008, the types of credit granted by financial companies are:

- corporate credit;
- credit to large, medium, small and micro companies;
- revolving consumer credit;
- non-revolving consumer credit; and
- mortgage credit.

Standard form documentation

Standard form contracts for users of the financial system who qualify as consumers must be approved by the SBS and must comply with the requirements provided for under the Consumer Protection and Defense Code (Código de Protección y Defensa del Consumidor) – Law 29571 and the Regulations on Market Conduct Assessment of the Financial System (Reglamento de Gestión de Conducta de Mercado del...
Are there any other notable risks or issues around borrowing?

As mentioned before, it is advisable for borrowers to consider if the lending regimes apply to their activities in order to determine if certain benefits of protection are applicable to them.

In addition, borrowers, before entering into loan agreements, should be aware of the potential implications of the occurrence of events of default and the consequences expressly established in the loan agreement (such as prepayment of all amounts that were lent and penalties to be applied).

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' or attorneys'-in-fact powers that would be preventative. Under Peruvian law, directors have a general duty to promote the success of the company for the benefit of its members as whole. Directors will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security. A safe approach is often to have the shareholders or authorized members of the company approve the giving of the guarantee or security by resolution.

Insolvency

 Guarantees and security may be at risk of being set aside under Peruvian insolvency and bankruptcy laws if the guarantee or security was granted by a company within a certain period of time prior to the onset of insolvency. This would be the case if the company giving the guarantee or security received considerably less consideration, and as such, the transaction was at an undervalue. For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within one year of the onset of insolvency of the affected party. Guarantees and security may also be challenged on other grounds relating to insolvency.

What are common types of guarantees and security?

Common forms of guarantees

 Guarantees can take a number of forms under the Peruvian law with a majority of them having a payment guarantee nature, covering the payment of money (compensation, penalties, and reimbursement) and other contractual obligations.

Common forms of securities

There are four basic types of security interests that can be created under Peruvian law:

- a pledge (garantía mobiliaria);
- a charge;
Different types of securities are suitable for securing different types of assets.

Under Peruvian law it is possible to grant security over all the assets of a Peruvian company or individual assets. Granting security over all of a company’s assets will tend to be achieved by way of a debenture which will include:

- a mortgage over real estate;
- a fixed charge over assets which are identifiable and can be controlled by the creditors (such as equipment);
- a floating charge over fluctuating and less identifiable assets (such as stock); and
- an assignment by way of charge over receivables and contracts.

Are there any other notable risks or issues around giving and taking guarantees and security?

Granting or taking guarantees

To be valid, a guarantee needs to be in writing, signed by the guarantor and provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations are usually the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this should not be an issue. Also, it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary, for example between the borrower and lender. As a result, guarantees are often executed as deeds to avoid any argument about whether good consideration was provided. Deeds have particular execution requirements under Peruvian law which need to be observed.

Additionally, there is a risk that a guarantee may be set aside if it was procured by undue influence by a borrower or lender. A party being provided with a guarantee should be aware of this issue and take all necessary actions to avoid claims of undue influence by, for example, requiring the guarantor to take separate legal advice.

Granting or taking security

A security instrument may need to be executed as a public deed (escritura pública) if it:

- contains a mortgage over land or any other assets specified as fixed assets under the Peruvian Civil Code;
- confers a statutory power of sale and power to appoint a receiver; or
- contains a power of attorney.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can include having the secured asset delivered to the security holder and registration of the security in the Peruvian Public Registry Office, depending on the type of security granted.

Mortgages are required to be notarized and registered in the Peruvian Public Registry Office to be valid and enforceable.

Like guarantees, for a period after a new security interest has been granted (known as the hardening period), it is at risk of being set aside in certain circumstances under insolvency laws.
Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

The General Act of the Financial and Insurance Systems and Internal Organization Act of the Superintendence of Banking and Insurance (Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros) – Law 26702

The Securities Act (Ley del Mercado de Valores) – Supreme Decree 093-2002-EF

Regulations on the Initial Public Offering of Marketable Securities (Reglamento de Oferta Pública Primaria y de Venta de Valores Mobiliarios) – Resolution SMV 141-1998-EF/94.10

Consumer credit

The Consumer Protection and Defense Code (Código de Protección y Defensa del Consumidor) – Law 29571

Regulations on Market Conduct Assessment of the Financial System (Reglamento de Gestión de Conducta de Mercado del Sistema Financiero) – Resolution SBS 3274-2017

The Supplemented Act on Consumer Protection in Financial Service Matters (Ley Complementaria a la Ley de Protección al Consumidor en Materia de Servicios Financieros) – Law 28587

Mortgages

The Peruvian Civil Code (Código Civil Peruano) – Legislative Decree 295

The General Security Interest Act (Ley de la Garantía Mobiliaria) – Law 28677

Corporations

The General Business Corporations’ Act (Ley General de Sociedades) – Law 26887

Regulations of the Registry of Companies (Reglamento del Registro de Sociedades) – Resolution 200-2001-SUNARP-SN

Funds and platforms

The Investment Funds and their Management Companies Act (Ley de Fondos de Inversión y sus Sociedades Administradoras) – Legislative Decree 862

Regulations on Investment Funds and their Management Companies Act (Reglamento de Fondos de Inversión y sus Sociedades Administradoras) – Resolution SMV 029-2014-SMV/01

Regulations on Mutual Funds and their Management Companies Act (Reglamento de Fondos Mutuos de Inversión de Valores y sus Sociedades Administradoras) – Resolution Conasev 068-2010-SMV/01

The Collective Fund Act (A las Empresas Administradoras de Fondos Colectivos contralará SMV) – Executive Order 21907

Regulations on the Collective Funds System and their Management Companies (Reglamento del Sistema de Fondos Colectivas y de sus Sociedades Administradoras) – Resolution SMV 020-2014-SMV/01

Other key market legislation

The General Bankruptcy System Act (Ley General del Sistema Concursal) – Law 27809

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Regulatory authorization

Who are the regulators?

The Superintendence of Banking, Insurance and Private Pension Fund Management Companies (Superintendencia de Banca, Seguros y AFP, or SBS) is a constitutionally autonomous institution in charge of the regulation and supervision of the financial, insurance and private pension fund system in Peru and the companies that are part of it, being the conduct regulator for firms and companies providing banking and financial services. It enjoys functional, administrative and economic independence.

The Superintendence of Securities Market (Superintendencia del Mercado de Valores, or SMV) is a specialized technical entity attached to the Ministry of Economy and Finance whose purpose is to protect investors, ensuring the efficiency and transparency of the markets under its supervision, as well as of the correct firm pricing and the dissemination of the necessary information for such purposes, through its regulatory, supervisory and promotional functions. It enjoys functional, administrative, economic, technical and budgetary independence.

Both Peruvian institutions are entitled to initiate administrative and sanctioning procedures against entities that are under their supervision and, when applicable, apply sanctions that include warnings, economic fines and revocation of licenses.

What are the authorization requirements and process?

Any company which intends to provide banking and/or financial services must apply to the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) for:

- authorization for the organization of the company; and
- authorization for the operation of the company.

The procedure and requirements are regulated by the General Act of the Financial and Insurance Systems and Internal Organization Act of the Superintendence of Banking and Insurance (Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros) and the Regulations for the Incorporation, Reorganization and Establishment of Companies and Representatives of the Financial and Insurance Systems (Reglamento para la Constitución, Reorganización y Establecimiento de Empresas y Representantes de los Sistemas Financiero y de Seguros), enacted by Resolution SBS 10440-2008.

The SBS will assess whether the application meets the required threshold conditions within:

- 180 calendar days from the submission of the complete application for the establishment, authorization; and
- 220 calendar days from the submission of the complete application for the operating permit.

For authorizations requested by banks or financial firms or investment banks, the opinion of the Central Reserve Bank of Peru is required.

On the other hand, any company with the intention of participating in operations conducted and executed in the securities market, such as brokerage firms, stock exchanges, securities clearing, securitization companies, mutual fund management companies, investment fund management companies or collective fund management companies must apply to Superintendence of Securities Market (Superintendencia del Mercado de Valores, or SMV) for:

- authorization for the organization of the company, and
- authorization for the operation of the company.

The procedure and requirements are established based on the type of entity to be incorporated or the services to be provided.

In both cases, individuals and legal companies applying as organizers must demonstrate moral integrity and financial capacity. Board and management members must demonstrate the required technical ability for the running of the company.

There are no application fees for the submission and assessment of the applications submitted before the SBS. For any authorization to be granted by the SMV, an application fee of PEN 3,850 (equivalent to approximately US$1,140) must be paid for each procedure.
Authorized firms and individuals are listed on the SBS' and SMV's websites.

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**What are the main ongoing compliance requirements?**

Many threshold conditions (such as having adequate financial resources, a minimum capital stock and compliance arrangements in place) are also ongoing compliance requirements for authorized firms.

These include:

- minimum capital and equity capital (basic equity and supplementary capital) requirements;
- risk concentration limits, which are based on a firm's equity capital global limits (these limits are overall limits, global limits for operations, individual limits, related individuals exposures and foreign companies and corporate group exposures);
- general and specific provisions for loans granted according to a firm's level of risk; and
- functions (companies must have at least an audit unit, a risk unit, an anti-money laundering system, a market conduct officer and a law compliance officer).

Failure to comply with the threshold conditions and more detailed regulatory rules allow the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS), in addition to imposing the applicable sanctions, to directly supervise the operation of the relevant firm and to request financial and internal information in order to determine if the failure to comply will be resolved. If the situation has not been resolved within the period of time given to the relevant entity, the SBS is entitled to intervene in the administration of the company and, when necessary, to initiate its dissolution and liquidation.

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**What are the penalties for failure to be authorized?**

An individual or company undertaking a regulated activity without being authorized is a criminal offence, punishable with imprisonment and further monetary penalties.

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**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

An individual or company must not carry on any regulated activity in Peru unless authorized or exempted (known as the general prohibition).

A financial or banking activity requires regulatory authorization to carry out specific activities in Peru where such activities do not fall within any of the available exemptions.

- Specific activities include activities such as accepting deposits; dealing in, managing, arranging and advising on investments; and establishing collective investment schemes.
- Specific investments include deposits, shares, debt instruments, options, futures, units in collective investment schemes, and government and public securities.

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**Are there any possible exemptions?**
In accordance with Article 87 of the Political Constitution of Peru, the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) authorizes, supervises and controls the activities of all banks, financial firms, insurance companies and any other firms that receive money from the public.

Credit Unions (cooperativas de ahorro y crédito no autorizadas para captar recursos del público) which can receive deposits and grant loans from/to their members do not need for a business license; nevertheless, they must register in the National Credit Unions Registry conducted by the SBS.

Without prejudice to the foregoing, unless otherwise expressly provided for by a special law, agreements relating to private financial and investment activities that do not involve public money can be executed without permit or authorization, in addition to other activities that may be excepted for having a different nature, such as making introductions (that is, making arrangements under which clients can, under certain circumstances, be introduced to another person).

Do any exchange controls or other restrictions on payments apply?

Peru has implemented no foreign exchange controls.

The exchange rate policy in Peru may be defined as a floating rate with the possibility of Central Reserve Bank of Peru intervening in the market in order to preserve monetary stability. Consequently, the exchange rate between currencies is free and can be established by any private entity for any purpose without the Central Reserve Bank of Peru or other institution intervening in it.

The Political Constitution of Peru guarantees the free possession and disposal of foreign currency.

In case of money transferring from non-Peruvian firms, imports of foreign currency may need to be declared in the customs declarations for their transfer in and out of the country.

There may also be anti-money laundering, anti-terrorism financing and tax considerations to be taken into account.

What are the rules around financial promotions?

According to the Stock Market Promotion Act – Law 30050, every advertisement or offer made in Peru, to buy or sell or subscribe securities through mass media such as newspapers, magazines, radio, television, mail, meetings, social networking, internet servers located in Peru or other media or technology platforms, may only be done by companies authorized by the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) or the Superintendence of Securities Market (SMV).

There are specific promotion rules for specific financial products such as:

- consumer credit as provided for in the Regulations on Regulations on Market Conduct Assessment of the Financial System (Reglamento de Gestión de Conducta del Sistema Financiero) – Resolution SBS 3274-2017;
- mutual funds referred to in Resolution Conasev 068-2010-EF/91.10 (Reglamento de Fondos MUTUOS y sus Sociedades Administradoras);
- investments funds as referred to in in Resolution SMV 029-2014-SMV/01 (Reglamento de Fondos de Inversión y sus Sociedades Administradoras); and
- collective funds as referred to in Resolution SMV 20-2014-SMV/01 (Reglamento del Sistema de Fondos Colectivos y de sus Empresas Administradoras).

Promotion rules broadly relate to the obligation of including or not including certain information in the promotion materials relating to financial products.

Additionally, any promotion – including financial promotions – must follow publicity rules that are set out in the Unfair Competition Act (Ley de Represión de la Competencia Desleal) – Legislative Decree 1044. Any promotion infraction may be punished by by the National Institute for the Defense of Free Competition and the Protection of Intellectual Property Rights (Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual) - INDECOPI, which is the national promotion and consumer protection authority.
Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The applicable law establishes that, unless express exceptions apply, banks and financial entities must be established as corporations (sociedades anónimas) with separate legal existence and limited liability for their members.

Corporations may either be privately held (denoted by the suffix sociedad anónima or SA) or publicly held (denoted by the suffix sociedad anónima abierta or SAA) depending on whether their shares are listed in the stock exchange.

Shareholders' liability may be limited by shares, in which case they are liable to pay for their shares but not for the company's debts, or by guarantee, where they are also liable to pay a certain amount if the company is wound up.

Funds

An investment fund is an independent autonomous entity made up by the contributions of individuals and legal entities to be invested in instruments, financial operations and other assets depending on the type of fund under management by a fund manager for the account of and at the risk of the fund shareholders.

The four types of types of funds commonly established in Peru are:

- private pension funds administrated by private pension fund management companies (contributions of individuals are made for investments in authorized securities for the individuals' retirement pension);
- investment funds administrated by investment fund management companies (contributions are made by a closed group for making investments in anything of their interest – investment fund management companies whose funds only issue trust certificates which are not to be placed through public offerings are not supervised by the Superintendency of Securities Market (SMV) and consequently are not subject to heavy regulation);
- mutual funds administrated by mutual fund management companies (contributions are made by an open group for making investments in securities); and
- collective funds administrated by collective fund management companies (periodical contributions of individuals or companies are made for acquiring goods or services of the interests of a group).

Fund Management Companies, on the other hand, tend to be set up as corporations (generally limited by shares) and must be authorized by the SMV or, in case of the Private Pension Fund Management Companies, by the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS).

Is it possible to conduct lending or investment business through a branch or establishment?

Yes, it is.

Legally, a company can conduct lending or investment business in Peru through an establishment (also known as a ‘branch’). The procedure for a company to request a license to operate a branch in Peru is regulated in Section 18 of Resolution SBS 10440-2008.

Foreign companies having a Peruvian establishment need to comply with the procedures for establishing a banking or financial entity, and are obliged to request an authorization from the SBS and, when applicable, the Central Reserve Bank of Peru. However, the supervision model of the SBS has been primarily developed to control and supervise subsidiaries but not branches. To date, there are no branches of
foreign banking or financial institutions operating in Peru.

Unless otherwise expressly provided for by specific laws or an international convention, foreign companies carrying on a trade in Peru through a 'permanent establishment' will be subject to Peru's corporation tax.

FinTech

FinTech products and uses

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending, given that specific regulations on this matter do not exist in Peru. Usual market practice includes companies lending money with their own capital and companies connecting investors and borrowers through a platform (either with or without knowing the identity of the applicant requiring financing). Marketplace lending is available to address mainly personal loans and is becoming available for small companies. Additionally, citizens may employ FinTech lending products available worldwide that accept Peruvian citizens.

As marketplace lending is just starting its development in the country and many projects are being developed, it is likely that the volume of lending in personal loans as well as further and additional product areas will significantly increase over the coming years.

Blockchain, smart contracts and cryptocurrencies

*WHAT IS BLOCKCHAIN?*

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized can validate, observe
and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

At the time of writing, there is only one Peruvian company that operates using the blockchain platform to exchange cryptocurrencies, specifically bitcoins, from dollars or soles; however, Peruvian citizens can operate cryptocurrencies through platforms that accept them. Therefore, it is not common for commercial establishments to accept cryptocurrencies as payment method.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so called 'Oracles'. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

**WHAT IS A CRYPTOCURRENCY?**

There is no legal definition of cryptocurrencies in Peru. The exchange of cryptocurrencies is not regulated by Peruvian laws but it may be considered as a foreign currency that may not be limited since the free possession and disposal of foreign currency is guaranteed by the Peruvian Political Constitution. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:
• availability and limitations on the total amount of the tokens;
• decision-making process in relation to the rules or ability to change the rules of the scheme;
• nature of the project to which the tokens relate;
• technical milestones applicable to the project;
• basis and security of underlying technology;
• amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
• quality and experience of management; and
• compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

To our knowledge, there have not been any ICOs led out of Peru at the time of writing.

**Electronic money**

Law 29985 regulates a range of matters, including the issuance of e-money. Electronic money is a monetary value represented through an enforceable credit to its issuer for the same amount of the money received, which is stored in an electronic medium, allowing the user to carry out payments without using cash or credit cards. According to Law 29985, issuers may rely on financial institutions, such as banks or other financial companies authorized by the Superintendence of Banking, Insurance and Private Pension Fund Management Companies to carry out such activity or use specialized companies for issuing money. The purpose of this product is to be an instrument for financial inclusion for people who would not otherwise have access to alternative financial products, so that they may pay by means other than cash (which is the most common payment method in Peru).

**Artificial intelligence, robo advisory systems and auction systems**

Recommender systems include software tools that provide information published and provided by traditional financial institutions (such as banks, financial entities and fund management companies) to users in order for them to make a decision to acquire financial products that fit their needs. The recommender systems available do not analyze personal data; therefore, they are not suitable for financial products that consider those parameters to advise in areas such as lending but they are functional for deposit and investment products.

Robo advisory systems which analyze personal data and other values are being developed for acquiring loans and are beginning to operate in the finance marketplace. These systems utilize algorithms relating to a person's historical information and the characteristics of financial products in order to rate the risk profile and display the best offers or products available according to the person's appetite for risk.

Auction systems for financial products such as deposits and loans based on recommender systems and robo advisory systems for deposits and loans also exist in Peru. Through auction systems, the developer of the FinTech application makes alliances with different financial companies so that the latter may give a specific offer to the client suitable to their requirements.

*Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?*

**General financial regulatory regime**

In Peru, the main applicable regulations are the General Act of the Financial and Insurance Systems and Internal Organization Act of the Superintendence of Banking and Insurance – Law 26702 and the Securities Act – Executive Order 861 which regulate lending and public offering of securities. There is not a specific regulatory regime for FinTech products.

Lending will be considered to be a regulated activity if it is conducted using public money which is defined as funds obtained from individuals. Under these circumstances, a lender will need to be authorized by the Superintendence of Banking, Insurance and Private
Pension Fund Management Companies to conduct such business.

A public offering of securities is, on the other hand, a public invitation to one or more individuals or legal entities of the general public, or specific segments thereof, to carry out a legal placement, acquisition or disposal of marketable securities. It is important to highlight that it is not necessary to state that the activity is employing securities; the Superintendence of Securities Market considers that it is enough that the characteristics of the financing fit in the definition of public offering of securities.

Regulations on crowdfunding and peer-to-peer lending

CURRENT SITUATION

There is no specific regulation on crowdfunding and peer-to-peer (P2P) lending. However, this activity may fall within the definition of a public offering of securities making it subject to the general financial regulatory regime.

WARNING FROM THE REGULATOR

The position of the Superintendence of Securities Market is that financing by crowdfunding through securities issuing is a non-authorized activity. Moreover, the Superintendence of Securities Market warns the public against investing through entities that promote crowdfunding through securities as they may not have the required license. The statement extends and applies to initial coin offerings as they follow a similar purpose.

REGULATION PROJECTS

Both public and private sectors recognize the need to enact specific regulation on crowdfunding and P2P lending. Consequently, there have been some initiatives, particularly from the private sector, for implementing an act issued by Congress, appointing the Superintendence of Securities Market as the natural supervisor of these activities. However, it is been discussed if there is a need to have a FinTech regulation in Peru instead of applying the general rules.

Moreover, there is consensus on the fact that FinTech regulations must be flexible enough for promoting FinTech development in Peru.

Regulations on payment services

There are no specific regulations for payment services. It is therefore not in scope of the general financial regulatory regime, and currently no specific authorization from the regulator is required to carry on this activity.

Application of data protection and consumer laws

The Data Protection Act, Law 29733, regulates the processing of personal data within Peru which aims to guarantee the fundamental right to protection of personal data and must be applied by public entities and private companies. Whenever any personal data is processed, it will be regulated by the Data Protection Act and be subject to certain registration and compliance obligations such as:

- registration requirements with the National Registry of Data Protection;
- obtaining consent for processing and treatment of personal data from clients, providers and employees; and
- restrictions on using data for purposes other than those for which personal data was given, amongst others.

Anti-money laundering regulations

The Anti-Money Laundering Act, Law 27693, establishes the obligation for companies, depending on the business activity they perform, to implement an anti-money laundering system which allows them to satisfy certain registration and compliance obligations. Among others included in the list prepared by the Financial Intelligence Unit (which itself is part of the Superintendence of Banking, Insurance and Private Pension Fund Management Companies), companies subject to the anti-money laundering regulations are:

- financial companies;
- credit unions;
- credit and debit card issuers;
Individuals or legal entities engaged in foreign exchange activities;
brokerage firms, stock exchanges, securities clearing, mutual fund management companies, investment fund management companies, collective fund management companies.

The main obligations within the framework of the anti-money laundering regulations include:

- appointment of an employee as the anti-money laundering compliance officer;
- adoption of internal regulations such as employee manuals;
- implementation of policies in relation to know-your-clients-and-workers requirements;
- implementation of an operations log; and
- reporting of suspicious operations.

However, the specific regulations applicable to a company depends on the entity type; therefore, obligations may vary between different types of companies.

What type of funding arrangements and incentives are available to FinTech businesses?

Seed investment

Initial investment in FinTech business may be provided by families and friends of the founders through their own capital and other high-net-worth individuals that invest in the FinTech business in return for an equity stake (often known as business angels). Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers. There are some private initiatives in Peru that aim to link business angels with FinTech businesses.

Venture capital

Venture capital funding is a type of equity investment usually targeted at early-stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest in companies that have already received investment through venture capital. Local investment funds, whose target is venture capital investment, are being developed to fund FinTech businesses that are already developed and need to grow. In addition, overseas funds and other entities are starting to invest in Peruvian FinTech initiatives.

State investment

The Peruvian state has initiatives which provide lending to encourage seed investment for starting businesses and venture capital for business that need to grow through the Production Ministry. Additionally, the National Council of Science, Technology and Technological Innovation (Concytec), which is the government entity engaged in promoting the development of technology, has different funds for financing science and technology.

Bank debt and capital markets funding

Currently, FinTech is considered to be a potentially risky business at an early stage of development. Consequently, banks are not promoting this type of debt in the market. Moreover, as the FinTech sector is not yet advanced in Peru, FinTech companies are unlikely to
obtain financing through the capital markets. Nevertheless, as the FinTech business consolidates in the country, it is expected that its funding would diversify.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common in Peru.

A loan may be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are through assignment, which may be either a transfer of rights only and not obligations, or a complete transfer of a contractual position (including rights and obligations). Subject to any contractual restrictions, assignment of rights can be executed without the consent of the debtor, while assignment of a contractual position requires the consent of the debtor.

Loan transfers are commonly documented using standard form contracts proposed and negotiated by and between the financial entities. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors.

Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties or, if applicable, authorization of the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS).

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally
Private entities are entitled to invest in Peruvian energy and infrastructure projects. Based on the location and the regulatory framework, these projects may be:

- national projects;
- regional projects; and
- local projects.

Furthermore, these projects may be part of different sectors such as energy, aviation, rail, telecommunications, water, roads, waste, transport, education, health and justice/prisons.

**Energy**

Part of the electricity industries in Peru are privatized, with the generation, transmission, distribution and supply services provided by a number of companies of the private sector. Thus, all transmission activities in Peru are developed by private companies and the generation and distribution assets are owned by different public and private companies.

Regarding the transmission system, the National Interconnected Electrical System (Sistema Eléctrico Interconectado Nacional, or SEIN), is in charge of the operation of the transmission network in Peru. This system interconnects most of the transmission lines in three geographical areas (north, central, and southern regions). However, there are also ‘isolated’ systems, not linked to the SEIN, which cover the rest of the country and are owned by private sector companies.

The private sector finances and delivers most of the required infrastructure but there are a number of government policy mechanisms (adopted through legislation) which are used to promote investment in eligible energy generation technologies. In certain instances, including on major energy infrastructure, projects may be procured by the public sector and depending on the terms of the procurement, the asset may either be publicly or privately owned.

The Ministry of Energy and Mines is the main body with responsibility for regulation of the energy sector in Peru. The relevant regulatory authority responsible for ensuring the quality and efficiency of service provided by private companies in the energy market is the Supervisory Agency for Private Investment in Energy and Mining (Organismo Supervisor de la Inversión en Energía y Minería, or OSINERGMIN).

**Telecoms infrastructure**

The telecommunications networks in Peru have been privatized to a number of private companies which provide telecommunications services. All the companies that provide telecommunications services are heavily regulated by government.

The Ministry of Transport and Communications (MTC) is the main authority of the Peruvian telecommunications sector. It also has responsibility for wireless communications services. Further, the Supervisory Agency for Private Investment in Telecommunications (Organismo Supervisor de la Inversión Privada en Telecomunicaciones or OSIPTEL), is the regulatory authority created to ensure the quality and efficiency of service provided in the telecommunications market.

**Transport infrastructure**

**LIGHT RAIL**

The only light rail system in Peru is located in Lima. Typically, rail assets (such as trams and associated track) are owned by the national public sector. However, the first light rail system project in Peru has been outsourced to a private sector company which is currently running a concession. The Ministry of Transport and Communications (as the main authority in the sector) has projected the development of more lines in Lima and in other cities thereafter.

**HEAVY RAIL**

The rail market in Peru involves both public and private entities. The rail assets are owned by local and national public sector but certain elements of rail projects have been outsourced to the private sector, for example, the private sector may operate and maintain rail systems on behalf of the Directorate of Railways. The assets will continue, however, to be owned by the public sector.

The rail sector is regulated by the Directorate of Railways (Dirección de Ferrocarriles) which is part of the Ministry of Transport and Communications.
ROADS, BRIDGES AND TUNNELS

A government entity, the General Directorate for Land Transport (Dirección General de Transporte Terrestre) is a nationwide agency that operates, maintains and improves the motorways and major roads in Peru and is part of the Ministry of Transport and Communications. The General Directorate for Land Transport receives funding from the government for investment in the strategic road network (including additional road capacity). Local roads in Peru are the responsibility of local authorities. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. In the case of tolled roads, the private sector has taken on roads/crossings on a full concession basis. It is responsible for the design, build, financing, operation, maintenance and collection of tolls for a number of years with the main revenue stream being the collection of toll revenues from users (rather than any service payments from the public sector). In some cases, the private sector provides toll collection services for a service fee rather than reeling on those tolls as its main source of revenue.

AVIATION

Airport infrastructure involves both public and private entities in the Peruvian market, national government ownership and some forms of public-private ownership. All models are regulated by government. The Civil Aeronautical Authority in Peru (Autoridad Aeronáutica Civil en el Perú) is the aviation regulator in Peru and is part of the Ministry of Transport and Communications.

PORTS

The ports sector also involves both public and private entities, including local and national government ownership and some forms of public-private ownership. This sector is regulated by government and the National Port Authority in Peru (Autoridad Nacional Portuaria), part of the Ministry of Transport and Communications, is the port regulator in Peru.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector with the private sector's responsibility being for any or all of the design, build, financing, operation and maintenance of the infrastructure. The majority of social infrastructure assets in Peru are directly financed by the government. Subject to value-for-money considerations, private finance may also be used in the procurement of social infrastructure assets. In relation to some of these specific sectors:

Education

The ownership of a school's infrastructure is owned by the Ministry of Education. The current program for new schools is through the 'National Program of Educational Infrastructure' (Programa Nacional de Infraestructura Educativa), delivering schools either through a traditional construction procurement or on a project-financed basis. This program seeks to develop infrastructure on three fronts: (i) high-performance schools (Escuelas de Alto Rendimiento), (ii) schools in risk areas (Escuelas en Riesgo) and (iii) Institutes of High Technical Education (Institutos Superiores Técnicos).

Hospitals

Ownership of hospitals is vested in various public sector bodies that are part of the national government (such as the Ministry of Health of Peru and Social Security System (ESSALUD), or local authorities (such as Hospitales de la Solidaridad or Regional Hospitals).

DEFENSE

All defense assets are owned by the public sector.

WASTE

The public sector procures new waste treatment or collection facilities and these are owned by the public sector even if the private sector is responsible for design, build, operation or maintenance of any given facility. Those waste treatments and collection facilities are owned by local authorities, which have competence to regulate all of the activities connected to such facilities. In the past few years, some private initiatives have been proposed to public authorities with regard to waste systems. However, such systems have not been successful due to the lack of clear regulation in connection with waste activities.
WATER

Water and wastewater (sewerage) services in Peru are delivered mostly by public sector companies (water companies) which own the relevant infrastructure assets and are located in each region of the country. For example, Servicio de Agua Potable y Alcantarillado de Lima (SEDAPAL) is a public company that provides water and wastewater services in Lima. Nonetheless, the public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. The National Sanitation Services Supervisory (SUNASS) is the regulator of the water sector in Peru and its functions are to establish norms, supervise providers, approve tariffs and resolve controversies and complaints, among other responsibilities.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in Peru over and above existing regulation for investors and funders, but a particular proposed investment may be subject to legislative or regulatory control (e.g., merger control rules in case of energy investments). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order, and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body (e.g., a government department, a local authority or a competent ministry of the corresponding sector) is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval. Key sector-specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public-sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on ‘change of control’. This is less of a concern on private sector infrastructure projects although investors would need to consider whether the validity of any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy markets in Peru have a complex system of arrangements between suppliers, generators, transmission and distribution in place, and are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customers, the Ministry of Energy and Mines, and OSINERGMIN. These arrangements are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies, particularly, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.

Further, investors should consider that obtaining licenses is not enough to guarantee the development of energy projects in certain areas. One major issue is to guarantee the ‘Rights of Way’ for the projects without generating a social problem by affecting property rights of third parties. In most of the cases getting along with the communities located around the project is as important as obtaining the relevant licenses and permits.

Telecoms infrastructure

There is a complex regulatory environment for this sector including how access and interconnectors (between networks) are regulated under the Legislative Decree 1019 – Law of Access to Infrastructure of Public Telecommunications Services and Access to Infrastructure regulations (Decreto Legislativo 1019 – Ley de Acceso a la Infraestructura de los Proveedores Importantes de Servicios Públicos de Telecomunicaciones) regarding access to infrastructure and how the Ministry of Transportation and Communications grants rights to access private or public land in order to install and maintain essential equipment in, over or under that land. This equipment might be cables sunk beneath the ground or a mobile mast sited on the ground. The Supervisory Authority for Private Investment in Telecommunications (OSIPTEL) is the regulator of the telecommunications sector in Peru and it is responsible for the following: rates
applicable to users; competition in the sector; interconnection; quality of the service; settlement of disputes between operators and application of the corresponding penalties; and dealing with complaints from users.

The industry is largely privatized; therefore, investors should consider if any permits/consents/licenses will be affected by their interest.

**Transport infrastructure**

**RAIL**

There is a framework to consider in respect of parties’ practical and operational involvement in this sector. Key issues for parties seeking to become involved in rail infrastructure include developing an understanding of the regulatory regime for certification for train use and acceptance and user fare regulation. Depending on how an investor wishes to invest in a project (specifically, depending on the type of entity or asset involved), there are varying degrees of difficulty for investors to contend with, particularly when entering into existing projects.

**ROADS**

In order for a private sector partner to carry out its duties on certain types of roads projects, the procuring public sector authority (Ministry of Transport and Communications or a local authority) may delegate certain of its statutory duties to the private sector partner. This will be dependent on the project and the specific contractual requirements. Any investor will, therefore, need to understand those duties and whether it is able to subcontract those duties to an appropriate person. There is usually a restriction on the change of control of the private sector partner during the construction period. Following the construction period, the relevant private sector partner may be allowed a change of control only with the prior approval of the Ministry of Transport and Communications or local authority. The precise scope of the restrictions will depend on the contractual terms of the project.

**Other infrastructure**

On publicly procured infrastructure, it is quite common for long-term projects to have a ‘change of control’ clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the construction period but this is often relaxed post-construction. How strict these restrictions are will often depend on the sector. For example, the defense sector usually gives the Ministry of Defense a strong degree of discretion (particularly on the grounds of national security) as to whether to accept a change in control over its private sector partner.

*What is the applicable procurement process?*

Public procurement in Peru is, for the time being, in most instances governed by the Law for Public Procurement and State Contracting. There are some sector-specific regulations such as Legislative Decree 1224 Public-private partnerships Law (Decreto Legislativo N° 1224 Ley Marco de Promoción de la Inversión Privada mediante Asociaciones Público Privadas y Proyectos en Activos), applicable to any sector and the Law of Electric Concessions (Decreto Ley 25844 Ley de Concesiones Eléctricas), among others.

The key principles are that contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

**Investing in energy and infrastructure**

Public procurement is relevant where the Peruvian government, or a branch of it, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to certain public bodies including central government departments, local authorities, police and fire authorities, among others. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

The general rule is that the public sector needs to follow a public tender. However, it could happen that some projects are generated under unsolicited proposals, which means that a private sector company may propose the development of a project to a public entity. Regarding public tenders, there are different regulations that may be applicable depending on the sector, for example the regulation
applicable to electric projects are regulated by different rules to those regulating transportation infrastructure projects.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements regarding the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Peru (including in relation to public-private partnerships) include the following.

Funding

- Loans made on a corporate finance basis (balance sheet debt)
- Loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders (for publicly procured project finance deals, this often means using private finance)
- Bond finance
- Mezzanine debt (in some sectors)
- Refinancing of the debt in operational projects
- Asset financing (this is particularly relevant in the rail sector)

In order to promote private investment in these activities, the Peruvian government has tried to expand the funding base and increase liquidity in the market (particularly by encouraging institutional investors) by various means. These include the Ministry of Economy and Finance of Peru offering financial and non-financial guarantees to assure certain types of debt on infrastructure projects (for example, guaranteeing bond finance debt so as to lower debt pricing to near gilt levels and offering a ‘minimum guaranteed income’).

Investing

- ‘Equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans
- Secondary market investment in operational projects (acquisition of ‘equity’)

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Superintendence of Banking, Insurance and Private Pension Fund Management Companies (SBS) or the Superintendence of
Securities Market (SMV) as applicable, considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation.

This may result in regulatory and monetary sanctions, in addition to criminal liability for the individuals involved if any criminal offence was committed.

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What regulatory penalties may apply?

When a rule breach has taken place, the authorities may impose a financial penalty or censure, or withdraw regulated status of the firm and/or regulated individuals.

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What criminal penalties may apply?

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the Anti-Money Laundering and Terrorism Financing Regulations;
- conducting regulated activities when not authorized; and
- bribery practices with public officials and private persons.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

In general, no stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

However, a tax on financial transactions would be applicable in the event that funds are transferred via local bank accounts. The tax is equal to 0.005% of the amount transferred.

Are the stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

No stamp, registration, transfer or other similar taxes are payable on the taking, transfer or assignment of a mortgage, debenture or other security.

It is advisable to register at the Real Estate Registry the taking, transfer or assignment of mortgages in order to make it enforceable against third parties. An administrative fee is required to be paid when registration of the taking, transfer or assignment of such mortgage takes place. The amount of the fee will depend on the amount of the mortgage.

Are the stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?
In general, no stamp, registration or other similar taxes are payable on the issue, transfer or assignment of a debt security.

However, in the case of bonds or other debt securities issued in the context of a public offering, a registration fee on the issue of such bonds/debt securities is required to be paid before the Superintendence of Securities Market (SMV).

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Tax authorities take priority on enforcement over secured lenders or secured debt security holders.

However, in the context of a bankruptcy proceeding, lenders or debt security holders may take priority over the tax authorities when the loans or the debt securities are supported under a warranty before the entry date of the debtor to such a proceeding.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Yes. Withholding tax is generally applicable to Peruvian-source interest payments paid by a borrower resident in Peru to a lender which is a legal person not resident in Peru or an individual who is not domiciled in Peru. Such withholding tax applies not just to interest payments but also extends to commissions and any additional amount to the interest agreed in loans, credits or any capital placed or economically used in Peru.

If so:

What is the rate of withholding?

LENDERS AS LEGAL PERSONS

In the case of interest payments to legal persons (ie not individuals) not resident in Peru, the general withholding tax rate is 30%.

However, the rate of withholding may be reduced to a rate of 4.99%, if all of the following requirements are met:

- the interest rate is not higher than LIBOR + 7 points (the excess would be subject to a withholding rate of 30%);
- the entry of the loan capital into Peru is attested in documentation; and
- the financing operation is not performed between related parties (including by way of back-to-back transactions).

In addition, in the case of interest payments to financial institutions a rate of 4.99% will be applied.

LENDERS AS NON-DOMICILED INDIVIDUALS

In the case of interests to individuals not domiciled in Peru, the general withholding tax rate applicable is also 30%.

However, the rate of withholding may also be reduced to 4.99%, if all of the following requirements are met:

- the financing operation is not performed between related parties (including by way of back-to-back transactions); and
- the interest payments are not derived from transactions made from or through tax havens.

What are the key exemptions?

The main exemptions from withholding tax in Peru apply to interest and related payments made on:

- development loans granted directly or indirectly by international organizations or foreign government institutions; and
An exemption from the application of withholding tax on interest or related payments may be applicable in part, under the terms of a double tax treaty entered into by Peru, provided that the requisite conditions are met.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Ricardo Escobar
Partner
DLA Piper Peru
rescobar@dlapiper.pe
T: +1 511 616 1200
Poland

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Polish and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Poland or to request that they are admitted to trading on a regulated market operating in Poland, unless an approved prospectus has been made available to the public.

The Prospectus Directive sets a standard for selling restrictions on offers of debt securities. These restrictions are aimed at preventing breaches of:

- the rules on financial promotion; and
- the rules on accepting deposits.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Poland are bonds issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in Poland. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating/variable-rate securities, and zero-coupon securities;
- bonds;
- mortgage bonds;
- public securities;
- bank securities; and
- subscription warrants.

What are the differences between offering debt securities to institutional/professional or other investors?
The **Prospectus Directive** does not make a distinction between professional and other investors for the purposes of its disclosure requirements, but it does include different disclosure regimes by reference to the minimum denomination of a single security.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the ‘wholesale’ rules apply. If the denomination is under €100,000, the ‘retail’ rules apply. Additional disclosure requirements apply for retail securities.

**When is it necessary to prepare a prospectus?**

Under the **Prospectus Directive**, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer would not be deemed to have been made to the public if it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per European Economic Area state, or where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a Prospectus Directive compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

**What are the main exchanges available?**

The Polish debt capital market includes:

- the main stock exchange market organized by the Warsaw Stock Exchange (WSE);
- NewConnect – an alternative stock exchange market organized by the WSE; and
- Catalyst – a bonds market.

The Main Market of the WSE is a regulated market for the purposes of the **Markets in Financial Instruments Directive** (MiFiD), so issuers on the Main Market are subject to the requirements of a number of EU Directives, including the Market Abuse Regulation, **Market Abuse Directive** and the **Transparency Directive**. Securities listed on the Main Market can be passported to other European Economic Area markets in order to access international investors.

NewConnect is an alternative stock exchange operated by the WSE, allowing smaller companies to float shares. The exchange is conducted outside the regulated market as a multilateral trading facility. Compared to the main market of the WSE, NewConnect offers lower costs for floated companies, simplified entrance criteria, and limited reporting requirements. It is also characterized by higher risk and in turn a higher rate of return.

The bond market operates on transaction platforms of the WSE and BondSpot, jointly organized by Catalyst, which comprises four trading platforms:

- two platforms operated by the WSE (a regulated market and an alternative trading system) are dedicated to retail investors; and
- two platforms operated by BondSpot (regulated market and ATS) are dedicated to wholesale investors.

All platforms support trading in non-treasury debt instruments: municipal bonds, corporate bonds, and mortgage bonds. The Catalyst’s architecture ensures that the market can accommodate issues of different sizes and parameters and serve the needs of different investor groups: wholesale and retail investors, institutions, and individuals.

The rules of trading on the regulated markets and in the alternative trading systems are identical and the only differences apply to block trades. Execution of transactions on all Catalyst markets is guaranteed by the National Depository for Securities. Issuers are bound by reporting requirements, including current and periodic reports.

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Is there a private placement market?

Poland has an active private placement market. There is no dominant standard for documentation.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Polish law. Poland has various statutory investor protection provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

With respect to changes of the terms and conditions of issue, there are various requirements with respect to consent that aim at protecting investors. For instance, a change of the terms of conditions of issue requires a resolution of the bondholders' meeting and consent of the issuer. Resolutions of a bondholders' meeting concerning amending the qualified provisions of the terms and conditions of issue have to be adopted by a majority of three-fourths of votes, and in the case of bonds admitted to trading on the regulated market or introduced to the alternative trading system, resolutions concerning amending the qualified provisions of the terms and conditions of issue require the consent of all the bondholders present during the bondholders' meeting. Moreover, resolutions of the bondholders' meeting concerning the reduction of the nominal value of bonds require the consent of all the bondholders present during the bondholders' meeting.

MIFID II Directive

Poland has implemented the MIFID II Directive, thus forcing the investment firms offering securities to disclose whom they represent while offering securities and limiting their possibility to charge commission and receive remuneration from the securities issuers.

Enhanced oversight of non-public securities trading

Following the Act of 9 November 2018 on amendment of certain acts in connection with strengthening the supervision over the financial market and protection of investors. All bonds (corporate bonds, bonds of security and closed-end investment fund certificates) offered by the Polish issuers or in Poland need to be dematerialized, meaning that bonds cannot be in the form of a printed document, but need to be registered with the National Securities Depository (Krajowy Depozyt Papierów Wartociowych or KDPW). They will exist only as an entry in the KDPW computer system, as is the case of securities traded on the Warsaw Stock Exchange.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing a fund, offering fund securities, and operating a fund are regulated activities under the Investment Funds and Alternative Investment Fund Managers Act.

Under Polish law, funds can be established in the form of an open-ended investment fund, a special investment fund, a closed-ended investment fund, or an alternative investment company. Open-ended investment funds are compliant with the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive. Closed investment funds and alternative investment companies are Alternative...
Investment Funds (AIFs). An investment fund is formed by the Investment Fund Company (Towarzystwo Funduszy Inwestycyjnych), which manages and represents the fund in its relations with third parties. The establishment of a public fund requires the consent of the Polish Financial Supervisory Authority.

Investment funds are subject to registration in the Investment Funds Register.

**Collective investment schemes**

Collective investment schemes are regulated under the UCITS Directive, which has been implemented in Poland. UCITS operate in Poland in the form of open-end investment funds.

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**What are common fund structures?**

Common forms of funds include open-ended funds, closed-ended funds, special open-ended investment funds, and alternative investment companies, Undertakings for Collective Investments in Transferrable Securities (UCITS) and non-UCITS funds.

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**What are the differences between offering fund securities to professional / institutional or other investors?**

**Retail funds**

Open-ended retail funds must be either authorized by the Polish Financial Supervisory Authority (PFSA) (if domiciled in Poland), or recognized by the PFSA (if domiciled in another jurisdiction). Funds that are 'recognized' by the PFSA in this context mostly comprise Undertakings for Collective Investments in Transferrable Securities (UCITS) funds established in other jurisdictions.

Retail funds, including UCITS, are subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depositary arrangements for assets, investment and borrowing power specifications (for open-ended retail funds), concentration requirements, and other matters.

**Institutional/professional funds**

Closed-ended funds are generally established as Polish closed-ended investment funds or Polish/offshore limited partnerships.

Non-retail funds that are offered in Poland generally fall into the category of Alternative Investment Funds and are therefore subject to the Alternative Investment Fund Managers Directive regime in relation to authorization of the manager/fund, marketing arrangements, reporting, governance etc.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

Managing investment funds is a regulated activity under the Act on Investment Funds and is therefore subject to authorization by the Polish Financial Supervisory Authority.

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**Managing and marketing debt / hedge funds**

**Are there any restrictions on marketing a fund?**
Selling restrictions

Generally, offering securities or units of funds in Poland is covered under the Act on Public Offerings and the Act on Investment Funds.

Undertakings for Collective Investments in Transferable Securities (UCITS)

UCITS, including those established in Poland, have an EU passport which enables fund promoters to create a single product for marketing in all EU member states. Upon the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other member state of the EU.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Managers Directive, marketing is defined as: a direct or indirect offering to or placement with investors domiciled or with a registered office in the EU of units or shares in an Alternative Investment Fund (AIF) at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM that manages the AIF.

An AIFM may only market an AIF to EU investors if it is authorized to do so by a relevant EU regulator. Subject to certain conditions, registration with one EU regulator allows marketing to professional investors across the EU under an EU passport or if it complies with national private placement regimes (where available).

Reverse solicitation and the regulation of ‘marketing’

Applicable in the context of professional investors, this is a sensitive area in Poland and Europe generally. The Alternative Investment Fund Managers Directive generally continues to permit professional investors to invest in Alternative Investment Funds based on their own initiative (reverse solicitation); however, the EU is currently reviewing this area and may impose tighter requirements.

In Poland, the Polish Financial Supervisory Authority (PFSA) has provided general guidelines on marketing for investment funds. The guidelines are not binding but they provide a framework for operating within the law. According to the Investment Funds Act, the PFSA can impose financial sanctions on a fund that is operating contrary to fair marketing rules.

Are there any restrictions on managing a fund?

Fund management in Poland is regulated under the Act on Investment Funds and Alternative Investment Fund Managers and is supervised by the Polish Financial Supervisory Authority (PFSA). The PFSA is responsible for supervising funds, fund managers and those marketing funds. It is prohibited for any legal or natural person to perform regulated activities, such as fund management, without authorization.

Under the regulations there are various restrictions on manager structure/compensation and profit-sharing arrangements and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and scope and complexity of activities.

Under EU law, Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the Undertakings for Collective Investment in Transferable Securities Directive.

The registration of such entities involves a significant authorization process. The application must include:

- for the manager – information on senior personnel (must be suitable persons etc), organizational structure, policies and procedures, remuneration practices; and
- for each fund – investment strategy, constitutional documents, depositary information and disclosure requirements.
However, AIFMs can be exempted from full regulation on certain grounds, including managing assets under €500 million where the assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers do not need a permit from the PFSA to operate but they still have to register in the Alternative Investment Company Register.

### Entering into derivatives contracts

**Are there any restrictions on entering into derivatives contracts?**

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of doing business in Poland (such as a dealer) will ordinarily have to be authorized under the Trading in Financial Instruments Act, if the transaction is one of the specified activities, such as:

- options;
- futures;
- contracts for difference; or
- rights to or interests in investments.

One of the key exclusions to the requirements above applies to persons that deal in derivatives for risk management purposes.

The [European Market Infrastructure Regulation](#) applies to all derivatives transactions and requires that transactions be reported to regulators and that transactions between dealers be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

### What are common types of derivatives?

Derivatives contracts are entered into in Poland for various reasons, including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

The main types of derivatives contracts are:

- forwards;
- futures;
- swaps; and
- options (call options and put options).

The Polish market for financial derivatives, although still fairly young, is high on the list of European markets. This is mainly due to the turnover on futures contracts, the most important derivative instrument listed on the Warsaw Stock Exchange, on the WIG 20 index.

Globally, the biggest influence on the financial market is attributed to instruments related to interest rates, which account for around 85% of the overall turnover. In Poland, this market is still very small and undeveloped. The largest turnover is generated on the over-the-counter (OTC) market in forward rate agreements and swaps.

Individual investors are not interested in speculation related to interest rates, and institutional investors conduct transactions on the OTC market. The situation is similar with respect to the currency derivatives market, where transactions, most commonly futures and options, are based on Polish currency.
Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives – and particularly over-the-counter derivatives – have attracted significant regulatory attention. The European Commission has sought to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

The grant of loans is not a regulated activity. However, lenders that grant loans must comply with civil law provisions relating to loans and collateral.

Consumer loans are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, there are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis; and
- to deal with borrowers who fall behind with their payments.

There is a set of regulations which defines caps on interest and non-interest costs that may be charged by lenders in connection with consumer loan agreements.

The EU Mortgage Credit Directive (2014/17/EU) is being implemented into Polish law through adoption of the Act on Mortgage Credit (Ustawa o kredycie hipotecznym). The Act on Mortgage Credit will apply the above-mentioned restrictions to mortgage credits.

In addition, regulated credit agreements have specific requirements around how the agreement is drafted and formatted and what information must be included.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether they are subject to consumer credit regulations.

What are common lending structures?

Lending in Poland can be structured in a number of different ways to include a variety of features, depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or on a syndicated basis (multiple lenders...
each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees that fulfil certain roles for the financing parties), are more highly structured, and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one member of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to the maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can be committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled.

Loan repayment

A loan can be repayable on an amortizing basis (in instalments over the life of the loan), or scheduled (usually meaning the loan is repayable in full at maturity).

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What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

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Do the laws recognize the principles of agency and trusts?

Trusts are not recognized under Polish law.

Polish law provides for certain types of agencies that may be used in financing transactions, eg pledge administrator (administrator zastawu) or mortgage administrator (administrator hipoteki), who will act on behalf of the secured parties.

In addition, the concept of the parallel debt is recognized by the Polish courts.

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Are there any other notable risks or issues around lending?
Generally

Loan agreements and other finance documents are subject to general contractual principles.

Specific types of lending

Polish law regulates consumer credit activities. For more information, see Regulated activities – authorization.

STANDARD FORM DOCUMENTATION

Most Polish law syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA).

Are there any other notable risks or issues around borrowing?

Borrowers face a number of systemic risks such as regional or national recessions, regional or national house price declines or national increases in interest rates. In response to the recent foreign currency loan crisis (the Swiss franc mortgage loans), i.e. mortgages which are denominated or indexed in a currency other than PLN the Act on the Borrowers Support was changed in 2019 by forming a separate Restructuring Fund, which will be used for voluntary restructuring of loans in foreign currency.

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD) (implemented in Poland by the Act of 10 June 2016 on the Bank Guarantee Fund, Guaranteed Deposit Scheme and Mandatory Restructuring), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' the obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of EEA law contracts, including Poland, such powers override what the contracts say. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into these contracts.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are:

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security, as they often provide that corporate authorization is required in connection with granting a guarantee or security.

Actio pauliana

If a third party has gained a benefit as a result of a legal transaction effected by a debtor to the detriment of its creditors (ie where the debtor became insolvent or became insolvent to a greater extent as a result of the transaction), each of the creditors may demand that the transaction be recognized as ineffective, if the debtor consciously acted to the creditors' detriment and the third party knew or with due diligence could have known about it (and it is alleged that the third party knew that the debtor acted to the creditors' detriment, if the third party remains in a permanent or close economic relationship with the debtor) or the third party obtained the benefit free of charge.
Insolvency and restructuring

Guarantees and security may be at risk of being set aside under Polish insolvency and restructuring laws if the guarantee or security was granted by a company a certain period of time prior to the onset of insolvency or restructuring proceedings.

Financial assistance

A joint-stock company may, directly or indirectly, finance the acquisition of or subscription for the shares that it issues, in particular by making loans, providing advance payments, or creating security, provided that the financing is granted on market terms and after the solvency of the debtor has been checked, the acquisition or subscription is for a fair price, the financing is made from the reserve capital created by the company for that purpose, and the financing is based on and is within the limits set out in an earlier resolution of the general assembly of the company. In the case of a limited liability company, the shareholders may not receive, under any title, any payments from the company's assets needed to fully finance the share capital.

What are common types of guarantees and security?

Common forms of guarantees

Guarantees can take a number of forms.

A particular distinction worth remembering is between a performance guarantee and a payment guarantee:

- Performance guarantee is a term used to describe both performance bonds (in the context of trade finance) and 'see to it' guarantees (in other contexts):
  - A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.
  - A 'see to it' guarantee is a promise by the guarantor to see to it that the primary obligor fulfills its obligations under the primary contract. If the primary obligor fails to fulfill its obligations under the primary contract, the guarantor will be in breach of its obligations under the guarantee.
  - A payment guarantee is narrower in scope than a performance guarantee as it only covers the payment of money rather than other contractual obligations.

Common forms of security

Polish law provides for real and personal security interests.

Personal security interests include:

- suretyship;
- guarantee; and
- statement on submission to enforcement.

The following types of security interest in rem can be created under Polish law:

- a pledge (under Polish law a distinction can be made between a registered pledge, a civil pledge and a financial pledge);
- a mortgage;
- a security assignment of receivables; and
- a security transfer of assets.

Different types of security are suitable for securing different types of assets.
Under Polish law, it is possible to grant security over all of the moveable assets and rights of a Polish company or over individual assets. Granting security over all of a company's assets may be achieved by the establishment of a registered pledge. However, real property cannot be encumbered with a pledge. The only security interest that can be established over the real property is a mortgage.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking security

Some documents creating security interest have to be executed in a special form, for instance:

- Statement on granting a mortgage has to be executed in the form of a notarial deed (there are certain statutory exceptions to this rule).
- Agreement for the establishment of a civil pledge over shares has to be executed in writing with signatures certified by a notary.
- Security assignment agreement and security transfer of assets have to be executed with a certified date.

Once granted, security often needs to be properly perfected before it is valid against third parties. Perfection formalities range from having the secured asset delivered to the security holder, registration of the security, and notice being given to third parties. For instance, registered pledges and mortgages have to be registered in the relevant registers.

Like guarantees, for a certain period after a new security interest has been granted (known as the hardening period), it is at risk of being set aside in certain circumstances under insolvency and restructuring laws.

In the case of a guarantor that is a limited liability company, the shareholders may not receive, under any title, any payments from the company's assets needed to fully finance the share capital.

For more information, see Tax issues – stamp taxes.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Act of 23 April 1964 – Civil Code (Ustawa z dnia 23 kwietnia 1964 r. – Kodeks cywilny) (civil code)

Act of 29 August 1997 – Banking Law (Ustawa z dnia 29 sierpnia 1997 r. – Prawo Bankowe) (banking law)

Act of 29 July 2005 on Public Offering, the Conditions Governing the Introduction of Financial Instruments to Organized Trading, and on Public Companies (Ustawa z dnia 29 lipca 2005 r. o ofercie publicznej i warunkach wprowadzania instrumentów finansowych do zorganizowanego systemu obrotu oraz o spółkach publicznych) (public offering and public companies)

Act of 29 July 2005 on Trading in Financial Instruments (Ustawa z dnia 29 lipca 2005 r. o obrocie instrumentami finansowymi) (financial instruments trading)

Act of 15 January 2015 on Bonds (Ustawa z dnia 15 stycznia 2015 r. o obligacjach) (bond issue and trading)

Act of 21 July 2006 on Financial Markets Supervision (Ustawa z dnia 21 lipca 2006 r. o nadzorze nad rynkiem finansowym) (financial markets)
supervision)

Act of 29 July 2005 on Capital Markets Supervision (Ustawa z dnia 29 lipca 2005 r. o nadzorze nad rynkiem kapitałowym) (capital markets supervision)

Act of 27 July 2002 – Foreign Exchange Law (Ustawa z dnia 27 lipca 2002 r. – Prawo dewizowe) (foreign exchange)


**Consumer credit**

*Act of 12 May 2011 on consumer credit (Ustawa z dnia 12 maja 2011 r. o kredycie konsumenckim) (consumer credit)*

**Mortgages and mortgage credit**

*Act of 6 July 1982 on Land and Mortgage Registers and on Mortgage (Ustawa z dnia 6 lipca 1982 r. o księgach wieczystych i hipotece) (land and mortgage registers and mortgage)*

*Act of 23 March 2017 on Mortgage Credit and Supervision of Mortgage Credit Brokers and Agents (Ustawa z dnia 23 marca 2017 r. o kredycie hipotecznym oraz o nadzorze nad porednikami kredytu hipotecznego i agentami) (mortgage credit) (NB The act enters into force on 22 July 2017.)*

**Corporations**

*Act of 15 September 2000 – Code of Commercial Companies (Ustawa z dnia 15 sierpnia 2000 r. – Kodeks spół handlowych) (company law)*

**Funds and platforms**

*Act of 27 May 2004 on Investment Funds and Alternative Investment Funds Management (Ustawa z dnia 27 maja 2004 r. o funduszach inwestycyjnych i zarządzaniu alternatywnymi funduszami inwestycyjnymi) (general investment funds law)*

**Other key market legislation**

*Act of 10 June 2016 on Bank Guarantee Fund, Guaranteed Deposit Scheme and Mandatory Restructuring (Ustawa z dnia 10 czerwca 2016 r. o Bankowym Funduszu Gwarancyjnym, systemie gwarantowania depozytów i przymusowej restrukturyzacji) (guaranteed deposit scheme)*

*Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)*

*Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)*

*European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)*

*Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)*

**REGULATION (EU) 2019/452 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union (the screening of investments from non-EU countries (foreign direct investment) that may affect security or public order).**

Last modified 6 Dec 2019

**Regulatory authorization**
Who are the regulators?

The Polish Financial Supervision Authority (Komisja Nadzoru Finansowego) supervises financial markets, including banking, capital markets, insurance market, pension market, financial conglomerates, electronic money institutions, payment institutions and payment service bureaus, as well as cooperative savings and credit unions.

The Polish Financial Supervision Authority carries out the licensing, regulatory, control and disciplinary function. The PFSA issues licenses for banks, cooperative banks, domestic payment institutions, insurance and reinsurance undertakings, open pension funds, investment funds or investment companies. The PFSA may impose financial penalties provided for by the law and withdraw license held by a financial institution. It may also issue individual recommendations for a specific entity or recommendations or guidelines aimed to affect the entire financial market sector. The PFSA analyses reports submitted by financial institutions on running basis and assesses whether they satisfy legally defined capital requirements. The scope of competence of the PFSA also includes carrying out control procedures in supervised entities.

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What are the authorization requirements and process?

In relation to performing banking activities, the PFSA has to be informed by the competent supervisory authorities of a home Member State about the types of operations to be performed by a credit institution.

Brokerage activities may be commenced by a foreign investment firm in Poland after the PFSA has been notified by the competent supervisory authority that has granted the investment firm license to perform brokerage activities, of the planned commencement of such activities.

EU payment institution or EMI (electronic money institutions) may commence cross-border activities in Poland after the PFSA has been informed by the competent supervisory authorities of a home Member State about a name, a registered seat, an address and types of payment services to be performed by such institution.

A firm must apply to the Polish Financial Supervision Authority for the relevant type of regulatory authorization.

The application fee depends on the type of application and ranges from PLN600 (approx. €140) to PLN13,000 (approx. €3,000). The application fee for the authorization of banking activity is equal to 1% of the share capital of the bank.

Authorized firms and individuals are listed in registers maintained by the Polish Financial Supervision Authority (eg register of investment firms or register of foreign investment funds).

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What are the main ongoing compliance requirements?

Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions being imposed on firms and regulated individuals, as well as the loss of regulated status.

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What are the penalties for failure to be authorized?

In principle, a person who performs a regulated activity without being authorized, or without having an exemption from the duty to be authorized, commits a criminal offence and may be fined or imprisoned.

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Regulated activities
What finance and investment activities require authorization?

Generally

A person must not carry on a regulated activity in Poland unless authorized or exempt from the duty of authorization (known as the general prohibition).

Regulated finance and investment activities include:

- banking;
- insurance;
- payment services;
- securities brokerage and trading;
- investment funds; and
- pension funds.

Consumer credit

Consumer credit activities are subject to certain statutory requirements in Poland. Loan companies which are not banks or credit institutions are not required to be authorized in order to grant consumer credits. However, it is a prerequisite for such loan companies and for loan intermediaries to obtain an entry in the register of loan institutions or, respectively, the register of loan intermediaries maintained by the Polish Financial Supervision Authority.

According to the Act of 12 May 2011 on Consumer Credit, a consumer loan is a loan granted to a consumer which is not exceeding PLN255,550 (approx. €59,000).

Are there any possible exemptions?

There are two types of exclusions permitting the performance of regulated activities without authorization:

General exclusions

Certain persons may carry on a regulated activity without being authorized, for instance EU-based payment institutions do not require authorization to conduct business activity within the scope of authorization granted by their domestic regulator.

Specific exclusions

For each type of regulated activity there are a number of specific exemptions that could also apply, for instance banks may conduct certain securities trading activities without securities trader license.

Do any exchange controls or other restrictions on payments apply?

Foreign exchange regulations are included in the Act of 27 July 2002 – Foreign Exchange Law and secondary legislations issued on the basis thereof.

There are certain restrictions on payments that apply in the case of non-Bilateral Investment Treaties (non-BIT) countries or countries that do not have agreements on partnership and cooperation, association agreements or other similar agreements, which would oblige Poland to enable the free flow of capital.
In addition:

- Importing or exporting domestic or foreign currency must be declared in writing to customs officials if the value of the currency exceeds the equivalent of €10,000 (this restriction does not apply in the Schengen area). Customs officials can also demand the presentation of imported or exported currency regardless of its value.

- International money transfers and domestic settlements relating to foreign exchange dealings shall be made with the intermediation of authorized banks or payment institutions or electronic money institutions authorized to provide payment services. In the case of making settlements within the country, they may also use payment services bureaus if the amount of transfer or settlement exceeds the equivalent of €15,000. This obligation does not apply to cases in which a party to the settlement is an authorized bank, a domestic payment institution, a branch of a EU payment institution, a domestic electronic money institution, or a branch of an EU electronic money institution.

Compliance with EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

Anti-money laundering and tax considerations may also need to be taken into account.

**What are the rules around financial promotions?**

A financial promotion is a communication of an invitation or inducement to engage in investment activity made by a person in the course of business. Only authorized persons are allowed to offer investment products and advise on engagement in investment activities.

It is a criminal offence for an unauthorized person to communicate a financial promotion.

**Exemptions**

Exemptions include intra-group financial promotions or free-of-charge financial advice given in the ordinary course of business.

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

The most common types of legal entities are limited companies and limited partnerships.

Limited companies take the form of limited liability companies and joint-stock companies, both of which are corporate bodies with separate legal personality.

Joint-stock companies can be either private or public, depending on whether their shares are offered to the public.

Limited partnerships are similar to limited companies in many ways, with the main difference being that they are formed by partners whose relationship is governed by a private agreement rather than having shareholders and directors.

**Funds**

Investment funds are legal persons which may take the form of open-ended investment funds, special open-ended investment funds, or closed-ended investment funds. Alternative investment companies (Alternatywna Spółka Inwestycyjna) may take the form of limited companies or limited partnerships, provided that the sole general partner is a limited company.

Fund managers (Towarzystwa Funduszy Inwestycyjnych) take the form of joint-stock companies.
Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A foreign company can conduct lending or investment business in Poland through a branch office (oddział), but this does not create a separate legal entity.

The branch office’s scope of activity must be exactly the same as that of the foreign company’s.

Opening a branch office through which a regulated activity will be carried out requires regulatory authorization, as in the case of a branch office of a bank. A credit institution with its registered office in the EU is exempted from this requirement and may start operating through a branch office or on cross-border basis following a notification to the Polish Financial Supervision Authority.

Another possibility for a financial institution to conduct business in Poland involves setting up a representative office (przedsiębiorstwo).

As with a branch office, a representative office is not a separate legal entity. However, the only activities that may be carried out by a representative office are the promotion and marketing of a foreign company.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- consumer loans;
- student lending products; and
- small and medium-sized enterprises (SME) lending.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P) type structures often operated through an electronic platform provider as well as crowdfunding and also direct to retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

Blockchain, smart contracts and cryptocurrencies
WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned'). Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

In Poland, a Polish accelerator of blockchain technology is working on the potential use of blockchain to support sectors such as:

- public administration (controlling the circulation of documents, digital identity and traceability of public assets);
- the health service; and
- the oil and gas sector.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

Smart contracts have not been formally classified as a manner of executing an agreement and therefore they are not regulated under Polish law. However, a declaration of will which constitutes an agreement may be expressed by any behavior which manifests the intent of a party to the agreement in a sufficient manner, including a disclosure of such intent by electronic means. Accordingly, agreements executed based on smart contracts technology are allowed, as long as they clearly demonstrate the intent of the parties.

It should be noted that certain types of agreements need to be entered into in a specific form (for instance in a written form or in a form
of a notarial deed). In such a case, application of smart contracts technology will not be possible.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

**WHAT IS A CRYPTOCURRENCY?**

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency). A Polish cryptocurrency – polcoin (PLC) – was created in 2004.

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety
of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

The cloud computing market is developing rapidly in Poland.

_Last modified 6 Dec 2019_

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

Due to the variety of products and legal constructions used in the FinTech industry, there is no one legal act in Polish law that comprehensively regulates this area. Depending on the specific product, the main pieces of legislation that need to be taken into consideration are:

- the Payment Services Act, which constitutes the legal framework for all types of payment services, including the issuance of payment instruments, e-money, and payment transactions;
- the Civil Code, which constitutes the main source of regulations referring to contracts in general, but also to certain specific agreements (e.g., loan agreements) – it also covers consumer law issues;
- the Consumer Credit Act, relevant for credit facilities and loans granted to consumers;
- the Consumer Rights Act, relevant if services are provided to consumers remotely;
- the Act on Anti-Money Laundering and Combatting the Financing of Terrorism; and
- the Foreign Currencies Act, which should be taken into account where currency conversion is involved in a given service.

Other pieces of legislation that may be of importance to providers of FinTech products include the Act on Personal Data Protection, the Act on the Provision of Services Online and the Act on Trade in Financial Instruments.

Furthermore, as FinTech products may be offered by regulated entities, certain legislation regarding the provision of services by such entities should also be taken into consideration, e.g., the Banking Law, the Act on Insurance and Reinsurance Activity, and the Act on Investment Funds and Alternative Investment Funds Management.

The recommendations of the Polish Financial Supervision Authority (Komisja Nadzoru Finansowego) constitute an important soft law complement to Polish legal regulations and in many cases will be applicable to the providers of FinTech products.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**Electronic payment platforms**

The main piece of legislation that regulates electronic payment platforms is the Payment Services Act. The act lays down rules governing the provision of payment services, including the acquisition of payments carried out over the Internet using electronic payment platforms. The scope of the act encompasses:

- the conditions for the provision of payment services, in particular regarding the transparency of contractual provisions and
information obligations with respect to the payment services;

- the rights and obligations of the parties resulting from the contracts on performance of payment services as well as the liability of providers of payment services;
- the principles governing the operation of payment institutions; and
- the basis of operation of the market of domestic payment transactions via payment cards and payment schemes.

PEER-TO-PEER LENDERS

Despite the fact that peer-to-peer lending systems exist in Poland, no specific legal regulations covering this type of business have been implemented. Accordingly, provisions of the Civil Code relating to loan agreement and contracts in general will be applicable to these types of services.

Regulation of payment services

The Payment Services Act is also the main piece of legislation regulating the provision of payment services. As noted above the provisions of the act include:

- the conditions for the provision of payment services, in particular regarding the transparency of contractual provisions and information obligations with respect to the payment services;
- the rights and obligations of the parties resulting from the contracts on performance of payment services as well as the liability of providers of payment services;
- the principles governing the operation of payment institutions; and
- the basis of operation of the market of domestic payment transactions via payment cards and payment schemes.

It should also be mentioned that a draft amendment to the Payment Services Act is currently in the legislative process. It is aimed at implementing Directive (EU) 2015/2366 (the Second Payment Services Directive). The purpose of the Second Payment Services Directive is to create uniform legal provisions in European Union member states concerning:

- reinforcement of consumer rights in the payment services area;
- reinforcement of the supervisory role of the European Banking Authority;
- promotion of the newest mobile and internet payment services; and
- enhancement of the security of payment services.

In addition, the role of Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions should also be mentioned. Together with the Second Payment Services Directive, it includes provisions that limit fees in relation to consumer credit and debit cards and it also forbids retailers from imposing extra charges for the use of cards.

Application of data protection and consumer laws

The REGULATION (EU) 2016/679 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) and Act on the Protection of Personal Data of 10 May 2018 is the generally applicable act in Poland, which has to be observed by FinTech businesses. It regulates the principles of data processing, the security of personal data, the registration of data files, and the transfer of personal data to a third country.

The Consumer Rights Act of 30 May 2014 regulates the obligations of the trader when contracting with the consumer, the procedure for the consumer to exercise his/her consumer rights, and the rules for concluding remote contracts with consumers (e-commerce).

The Consumer Credit Act of 12 May 2011 includes regulations and procedures for concluding consumer loan agreements, the lender's and credit intermediary's obligations in relation to pre-contractual information and the obligations of the consumer, lender and credit intermediary in connection with the executed consumer loan agreement as well as the sanctions for the failure to meet the lender's obligations.
The Polish Civil Code includes general principles for executing agreements with consumers, which are also applicable to FinTech businesses.

Money laundering regulations

The money laundering regulations which are applicable to FinTech businesses are included in the Act on Anti-Money Laundering and Counter Terrorism Financing; it lays down principles and procedures for counteracting money laundering and the financing of terrorism. It provides for the application of specific restrictive measures against natural and legal persons, as well as the obligations of entities involved in financial transactions connected to the collection and transmission of information related to such transactions.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

The FinTech industry is developing very well in Poland; however, some barriers still remain. Polish law does not include specific provisions which would facilitate provision of FinTech services or development of FinTech businesses at the early stage of their operation. Moreover, there remain certain difficulties in obtaining financing of FinTech startups.

SEED INVESTMENT

Seed investment is mostly used in the establishment of and early investments in a business. The vast majority of Polish FinTech startups indicate that the main source of funding at the early stage of their business activity comes from their founders' budget.

So-called business angels are an increasingly popular solution to finance FinTech startups. A business angel is a person who has his/her own capital and who wants to use it to finance new companies and new ideas. In exchange for their capital, business angels receive a minority stake in the company. In Poland there are a number of associations of business angels, including Lewiatan Business Angels or the Network of the Business Angels, ‘Amber’. Many FinTech startups cooperate with these associations.

CROWDFUNDING

Crowdfunding is a type of social financing and is one of the most popular solutions to finance startups in Poland. There are many crowdfunding platforms which provide an opportunity to present new projects and raise funds, including beesfund.com, odpalprojekt.pl, findfunds.pl.

ACCELERATORS

In Poland there are many incubators or accelerators that offer financial support for startups. The most popular is the ‘Start in Poland’ program, financed by European Union funds, which offers PLN 3 billion for initial investments in startups. The program is under the auspices of the Polish Ministry of Development.

Venture capital and debt

The financing of FinTech startups by venture capital funds, being investment funds that acquire private equity stakes in such startups using the money of investors (mainly Polish banks) is one of the most important sources of financing for FinTech startups in Poland. It should be noted however that it is targeted primarily at early-stage FinTech businesses.

Warehouse and platform funding

At this time there are no public examples of Polish FinTech companies using warehouse or platform funding as a source of financing for the purpose of developing their business.

Senior bank debt and capital markets funding

SENIOR BANK DEBT FUNDING

As a general rule, senior bank debt is available to FinTech businesses. In practice however, at the early stage of their activity, obtaining
senior debt funding may prove to be difficult. It stems from the high risk encumbering FinTech startups as well as lack of property which might secure the repayment of credit facility or loan.

**CAPITAL MARKETS FUNDING**

Raising funds through the capital markets, in particular listing shares on the Warsaw Stock Exchange, is available to FinTech businesses. In practice, only companies that are well established in the Polish market (such as eCard S.A.) have been able to raise capital via this method of funding.

**Incentives and reliefs**

The FinTech market in Poland is developing rapidly, but at the same time the legal and financial regulations are not supportive of new developments. Moreover, the government is not providing sufficient support for startups, which is needed due to the risk-averse approach of investors and entrepreneurs. There are no special incentives or reliefs directed solely at FinTech startups.

However, in 2017 the so-called Small Act on Innovation came into force. The act introduces a new tax relief for startups connected with the research and development sector.

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**Portfolio sales**

**Loan transfers and portfolio sales**

**What are common ways of buying and selling loans?**

Buying and selling loans is very common in Poland.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are as follows:

- **assignment** – the transfer of rights only, not obligations (subject to any contractual or statutory restrictions, assignment can be done without the consent of the debtor); and

- **sub-participation** – the transfer of the economic interest in a loan without changing the legal relationship between the existing parties (sub-participation involves the buyer taking on a double credit risk, both on the seller as well as the borrower).

The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;

- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;

- **lender eligibility** – whether there are any restrictions concerning the type of entity to which the loan can be transferred;

- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall upon the transferee or reduce claims made by the transferee;

- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

Most of the energy and infrastructure assets are publicly owned by local government bodies, government bodies, or state-owned companies.

Key sectors are considered below.

Energy

The gas and electricity industries in Poland are generally run by state-owned companies. Most of the generation, distribution and supply services are provided by six main companies, the biggest five of which are publicly listed but controlled by the State Treasury. All transmission assets are state-owned and cannot be purchased by private investors.

The oil industry is mainly run by two publicly listed companies that are controlled by the State Treasury. In the field of selling oil to consumers there are many private companies, including international groups.

The Energy Regulatory Office is the principal body with responsibility for regulating the energy sector in Poland.

Other infrastructure

TELECOMS

Telecommunications networks in Poland are privately owned by a number of companies, including service providers.

Postal services are mainly run by the state-owned company Poczta Polska, but there are also private companies operating in this sector.

The Office of Electronic Communications is the regulator of the Polish post and telecommunications sectors.

RAIL

Typically, light rail assets (such as trams and associated track) are owned by local public transport authorities. Certain elements of light rail projects may be outsourced to the private sector. Heavy rail infrastructure in Poland is mostly owned by the state-owned Polskie Koleje Pastwowe (PKP) Group. The exceptions are the railway electrification grid and railway sidings, which are owned by private entities.

The rail sector is regulated by the Office of Rail Transport.

ROADS

Roads, bridges and tunnels are owned by the state or by local authorities. The public sector may outsource the construction, operation and maintenance of some assets to the private sector.

Some motorways are privately owned and their functioning is heavily regulated.

AVIATION

The main aviation infrastructure in Poland is mostly indirectly owned by the state or by local authorities. Services connected with the functioning of airports are partly provided by private entities. Air carriers are both state-owned and private. All aviation activities are heavily regulated. The Civil Aviation Authority is the aviation regulator in Poland.
PORTS

The main port infrastructure is mostly indirectly owned by the state or by local authorities. Additional infrastructure such as warehouses is also owned by private entities.

HOSPITALS

Most hospital infrastructure is owned by public bodies. Some hospitals are private and their activities are heavily regulated.

EDUCATION

Most schools are owned by local authorities, but there are also private schools. Higher education in Poland is generally provided by the state but there are many private entities.

WAREHouses

Warehouses are mostly owned by private entities and operate on a commercial basis.

DEFENSE

Typically, defense assets are owned by the Polish Armed Forces. Some manufacturers of defense-related products are state-owned and some are private.

WASTE

The waste sector (waste services and waste infrastructure) is indirectly owned by local authorities and by private companies.

WATER

Rivers are treated as public property, not as commercial goods, and are maintained by the state and local authorities. Water services (including sewerage), depending on the town, are provided by private sector companies or local authorities.

Are there special rules for investing in energy and infrastructure?

Generally

There is a specific regime governing and restricting investment in energy or infrastructure projects in Poland. In some cases, the relevant minister can block the buying or selling of some class of assets or companies on the grounds of an overriding public interest such as public security. Some companies that own infrastructure assets are also obligated to perform some activities connected with public security, such as preparing emergency plans.

Energy and infrastructure investments may be subject to legislative or regulatory control, such as merger control rules.

As regards the planning and implementation of the underlying energy or infrastructure project (in which an investment is to be made), the legal or regulatory position relevant to the project must be considered. For example, a project involving development on land will require planning permission or a development consent order. Additionally, a project may require environmental authorizations, permits and/or sector-specific regulatory consent decisions or licenses. Environmental impact assessments may also be required.

Energy

The energy market in Poland has a complex and heavily regulated system of arrangements between suppliers, generators, transmitters and distributors. In particular, there are complex arrangements in respect of licencing, subsidies, and demand/charging mechanisms with suppliers, customers and the grid operator. These are subject to change and regular updates, which means that investors need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how changes in technology may impact the overarching regulatory framework and vice versa.
Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license that might make the potential target less attractive or viable. In Poland, unbundling and Third Party Access (TPA) principles are in force.

There are public policy mechanisms (adopted through legislation) which are used to incentivize investment in distribution and generation, especially in renewable energy sources.

**Other infrastructure**

There are specific sectoral provisions concerning other infrastructure. The relevant provisions depend on the specific project.

Telecommunications and transport infrastructure are especially heavily regulated, mostly by sectoral acts like the Telecommunications Law and the Rail Transport Act. For example, there is a complex regulatory environment in the telecommunications sector including issues such as access and interconnectors. The industry is largely in private hands, therefore investors should consider if any permits, consent decisions or licenses will be affected by their interest. The rail sector also has an extensive and complex regulatory framework with respect to practical and operational issues. Key areas include certification for train use and fare regulation. Depending on how an investor wishes to invest in a project (specifically, what type of entity or asset), there is a varying degree of difficulty in entering into an existing project.

*What is the applicable procurement process?*

Public procurement in Poland is, for the time being, in most instances governed by the Public Procurement Law Act, which is based on EU Directives.

The key principles are that contracts procured by the public sector must be awarded fairly, transparently and without discrimination on the grounds of nationality, and that all potential bidders must be treated equally.

**Investing in energy and infrastructure**

Public procurement is relevant where the Polish government, or a branch thereof, is seeking to outsource the delivery of a new project. On an infrastructure project, a potential investor would have to bid on its own or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance, and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to certain public bodies, including central government departments, local authorities, the police and fire authorities, and the National Health Fund. A regulated procurement is required where certain financial thresholds are met. On most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met, therefore a regulated procurement would be necessary.

In most cases, the public sector will need to publish a contract notice in the *Office Journal of the European Union* (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects and bidders simply submit an offer in response to the OJEU notice. Changes to the tender and negotiations are not permitted.
- **Restricted procedure** – There is a shortlisting of at least five bidders following an expression of interest stage and then the bidders submit their offers. Again, no negotiation is permitted (other than to clarify and finalize the contract terms).
- **Competitive dialogue** – This is the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to enter dialogue with the public sector contracting party to develop detailed solutions which are acceptable for the public sector. Clarifications and further negotiations are allowed following the final tender, but only to confirm the financial and other commitments in a bidder’s offer.
- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure because it allows dialogue with bidders but also allows the public sector contracting party to award a contract on the basis of an initial tender (or further stages), but clarifications and negotiations are not allowed after the final tender.

However, an investor may choose to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is already operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly...
procured projects) within the original awarded contract rather than by procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

Financing energy and infrastructure

On a publicly procured contract, the public sector contracting party may have prescribed requirements concerning the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector contracting party.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Poland (including in relation to public-private partnerships) are as follows.

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing (this is particular relevant in the rail sector).

Funding/funding products can also, sometimes, be provided by the European Investment Bank and export credit agencies.

Investing

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of ‘equity”).

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Polish Financial Supervision Authority considers that an authorized firm or regulated individual may have breached compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

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What regulatory penalties may apply?

The Polish Financial Supervision Authority may, among others, impose a financial penalty or withdraw the regulated status of the firm and/or regulated individuals. The regulator will publicize these penalties.

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What criminal penalties may apply?

Following a formal investigation, the regulators have the power to impose administrative and criminal sanctions for the following unlawful acts:

- insider dealing and misleading statements and practices;
- breaches of the Money Laundering Regulations; and
- conducting regulated activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

Grant (advance) of a loan

Yes, loan agreements (and amendments to such agreements, if they result in an increase of the principal) may be subject to the tax on civil law transactions (TCLT) at 0.5%. As a rule, loans granted by financial institutions and entities whose business activities are to provide finance are not subject to TCLT (as they are exempt from value added tax in relation to such transactions).

A loan agreement is subject to TCLT, if:

- the rights arising out of the loan agreement are exercised in the territory of Poland (where the loan is granted by a company not resident in Poland this condition is not fulfilled); or
- the rights arising out of the loan agreement are exercised outside of the territory of Poland but the borrower has its place of residence or registered office in Poland, and the loan agreement was executed in Poland.

Loans granted by a shareholder to a company (limited liability company or joint-stock company) are exempt from TCLT.

The TCLT obligation arises when the loan agreement is executed. Generally, the tax base is the amount or value of the loan (principal). If the principal is to be paid in tranches and the total amount of tranches is not known (eg because the agreement does not specify the total principal amount), the tax is due in relation to a given tranche once it is paid out. The borrower is obliged to calculate and pay TCLT within 14 days from executing the loan or receiving the tranche of the loan.

Transfer (assignment) of a loan

A transfer (assignment) of a loan may be subject to TCLT; where this is the case, the tax rate is 1%. The acquirer of the debt is liable to pay the TCLT.

There is no TCLT in the case of the subrogation of loans.
TCLT does not apply to the assignment of a loan agreement if at least one of the parties is subject to or exempt from value added tax in relation to the assignment.

**Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

There are court fees involved in the registration of registered pledges and mortgages in the relevant registers. Stamp duty is payable if the application to register a security is filed by an attorney-in-fact. Additional court fees are payable if any amendments to the registered pledges or mortgages are registered. In each case, the fees are not significant.

Notarial fees are involved when any security interest is executed in a form of notarial deed (eg mortgage) or with signatures certified by the notary (eg civil pledge over shares in a limited liability company) or with date certified by the notary (eg security assignment or security transfer of assets). In any case, the notarial fees are capped at PLN 10,000 (approx. €2,350).

The establishment of a mortgage is subject to TCLT. The tax rate is 0.1% of the amount of the secured debt if it is possible to determine the amount of such debt or PLN 19 (approximately €5), if the debt is of an amount which is not capable of being determined.

The TCLT obligation arises upon submission of a declaration on the establishment of a mortgage or conclusion of an agreement for the establishment of a mortgage. The tax base is the value of debt secured. The person submitting a declaration of intent concerning the establishment of a mortgage is liable to pay the TCLT.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?**

Generally, this depends on the type of debt securities and entities involved.

As a rule, a sale agreement relating to shares and stocks in a Polish company is subject to TCLT, as these stocks and shares are considered as rights exercised in the territory of Poland.

Sales of bonds will be subject to TCLT if they constitute rights exercised in Poland or if the acquirer is resident in Poland and the transaction is concluded in Poland. Usually, it is accepted that bonds are exercised where the creditor (ie the seller) is resident, but bond documentation should be analyzed in this respect on a case-by-case basis.

The TCLT is calculated as 1% of the market value of the shares/stocks/bonds. The tax is to be paid by the acquirer.

The following sales are exempt from TCLT:

- sales to investment companies and foreign investment companies;
- sales via investment companies or foreign investment companies (eg brokerage houses);
- sales as part of an organized trading; and
- sales outside organized trading by investment companies and foreign investment companies, if those rights were acquired by those companies under organized trading.

No stamp, registration, transfer or other similar taxes payable are payable on the issue of bonds.

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**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

There is no general rule of priority entitling the tax authorities to take priority over secured lenders or secured debt security holders during enforcement proceedings. Any priority is determined on the basis of general rules provided by law. For example, in the case of a compulsory mortgage established in favor of the State Treasury and a mortgage securing the rights of secured bond holders, it is the relative position of the mortgages which determines which mortgage is executed in the first place and therefore takes priority. If the
mortgage securing the bonds was determined as the mortgage with first position, then this mortgage will be treated as executed before the compulsory mortgage of the State Treasury and will take priority.

Notwithstanding the above, in the case of bankruptcy of a debtor, the law distinguishes certain categories of liabilities that should be paid by the bankrupt entity in a given order. In this respect, liabilities owed to tax authorities may be privileged – that is they are paid just after liabilities owed to employees and before liabilities owed to other unsecured creditors.

**Is withholding tax on interest payments applicable?**

**Is there withholding tax on interest payments under a loan?**

In principle interest paid under a loan to an entity which is not resident in Poland is subject to withholding tax.

Payments of interest to entities resident in Poland (but not individuals) are not subject to withholding tax.

**If so:**

**What is the rate of withholding?**

The general withholding tax rate on interest paid to entities which are not resident in Poland is 20%.

**What are the key exemptions?**

Interest payments to entities not resident in Poland may be exempt from withholding tax under the EU Interest and Royalties Directive as implemented under Polish law, provided that certain conditions are met. The withholding tax rate may be also reduced or eliminated based on relevant double tax treaty (DTT) concluded between Poland and the recipient's country of residence under certain conditions. Under most DTTs the withholding tax rate is limited to 10% or 5%. Some DTTs provide for a 0% withholding tax rate. Moreover, a number of DTTs provide for exemption applicable to interest payable to banks.

However, the Polish withholding tax (WHT) regime has been substantially amended with the 2019 corporate income tax reform. Under the new rules, WHT becomes obligatory for certain cross-border payments (including interest). Even when a lower rate or an exemption is available, for example under a bilateral tax treaty entered into by Poland, the WHT has to be withheld in full by the withholding agent based on Polish domestic law and remitted to the relevant tax authority. The tax authority may provide a refund after it has verified the right of the non-resident taxpayer to benefit from a reduced rate or an exemption. There are also alternative procedures which may allow to mitigate WHT (a description of these procedures can be found here).

In principle, the changes affect cross-border payments exceeding PLN2 million annually paid to a non-resident taxpayer.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes, the comments outlined above are applicable to interest payments under a debt security (like bond). However, with respect to new obligatory WHT, such WHT regime is excluded in case of receivables received by non-residents due to interest or discount on bonds issued by the State Treasury/BGK and offered on foreign markets.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.
Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Mariusz Hyla
Partner
DLA Piper Giziski Kycia sp.k.
mariusz.hyla@dlapiper.com
T: +48 22 540 78 22
Portugal

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Portuguese and EU law.

Unless certain exclusions or exemptions apply, the offering of debt securities to the public in Portugal and the request for admission to trade debt securities on a regulated market operating in Portugal requires disclosure to the public by way of an approved prospectus.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Portugal are bonds, notes and commercial paper issued on a stand-alone basis or under a programme. Many different types of debt securities are offered in Portugal. Some common forms include:

- debt securities characterized by a fixed rate of interest plus the right to a supplementary interest rate or a reimbursement premium, either fixed or dependent on the profits of the issuer;
- debt securities with an interest rate and repayment plan dependent on profits;
- debt securities convertible into shares or other securities;
- debt securities giving the right to subscribe one or more shares;
- debt securities giving subordinated credit rights over the issuer;
- debt securities convertible into other credits of shareholders or third parties over the issuer;
- debt securities providing special guarantees over assets or profits of the issuer or a third party;
- debt securities issued at a premium;
- cash bonds;
- equity securities;
- mortgage securities; and
- perpetual securities.

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What are the differences between offering debt securities to institutional/professional or other investors?

According to Portuguese law the offer of debt securities to qualified investors (credit institutions, investment firms, insurance firms, pension funds and managing firms etc.) is classified as a private offer. On the other hand, the offer of debt securities to an undetermined pool of investors is a public offer, provided the offer is not addressed to qualified investors only. Portuguese law only imposes requirements for disclosure by way of an approved prospectus for public offers.

When is it necessary to prepare a prospectus?

According to Portuguese law, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for securities to be admitted to trading on a regulated market.

An offer is deemed to have been made to the public if:

- it is made solely to an undetermined pool of investors or to the generality of the shareholders of a listed company, even if the share capital is represented by nominal shares;
- the offer is preceded or followed by a solicitation addressed to an undetermined pool of investors or general advertising promotion; or
- it is offered to more than 150 persons (other than qualified investors) per European Economic Area state.

If the offer is deemed not to be made to the public, a prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

What are the main exchanges available?

Regulated markets

The regulated markets in Portugal, for the purposes of the Markets in Financial Instruments Directive II (MiFID II) are:

- Euronext Lisbon (Sociedade Gestora de Mercados Regulamentados, S.A.);
- futures and options markets, managed by Euronext Lisbon (Sociedade Gestora de Mercados Regulamentados, S.A.); and
- OMIP Derivatives market, managed by OMIP - Operador do Mercado Ibérico de Energia.

These markets are subject to the requirements of several EU directives, including the Market Abuse Directive and the Transparency Directive.

Multilateral trading facilities

In Portugal there are the following multilateral trading facilities:

- Euronext Lisbon (Sociedade Gestora de Mercados Regulamentados, S.A.); and
- Alternext, managed by Euronext Lisbon (Sociedade Gestora de Mercados Regulamentados, S.A.).

Is there a private placement market?

Portugal has an active private placement market.
There is no dominant standard for documentation but it is usual to adopt internationally accepted models.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to administrative liability under Portuguese law and additional public sanctions.

Investing in debt securities

Debt security terms and conditions typically contain provisions which allow for modification without the consent of all investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors. These provisions typically allow defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

The establishment of investment funds and commercialization of investment funds’ units is supervised by the Portuguese Securities Market Commission and the Bank of Portugal, under the terms of the Legal Regime on Undertakings for Collective Investment in Transferable Securities.

Funds are one form of collective investment undertaking (which may be structured as a public limited company which are subject to further regulation). The conditional documents and proposed activities of funds require prior authorization from the Portuguese Securities Market Commission.

Collective investment schemes

In Portugal, there are two types of collective investment schemes.

INVESTMENT COMPANIES (SOCIEDADES DE INVESTIMENTO)

Investment companies are typically structured as public limited companies and are generally governed by the Commercial Companies Code and the Legal Regime on Undertakings for Collective Investment in Transferable Securities (except for certain activities that may conflict with typical activities of a collective investment scheme such as mergers, demergers or transformation regimes). Investment companies may be self-managed.

INVESTMENT FUNDS

Investment funds consist of an autonomous pool of assets. They do not have any legal personality and must be managed by a management entity. Investments funds are comprised of participation units and governed by the Legal Regime on Undertakings for Collective Investment in Transferable Securities. Unlike investment companies, investments funds may not be self-managed.

What are common fund structures?
Funds may be established as open-ended funds (with a variable number of units that may be redeemed at any time at the request of the unit holder) or closed-ended funds (with a fixed number of units).

There is a prescribed list of types of investment funds. The qualification of each fund is determined by the type of assets the fund holds, management of the fund and the characteristics of the units comprising the fund. Examples of funds include money-market funds which invest in money-market instruments and guaranteed funds in which an investor’s income is guaranteed.

**What are the differences between offering fund securities to professional / institutional or other investors?**

An offer of fund securities to qualified investors such as credit institutions, investment firms, insurance firms, pension funds and fund managers is considered a private offer. Conversely, an offer of fund securities to undetermined investors is considered a public offer, provided the offer is not addressed to qualified investors. Disclosure of an approved prospectus is only required for public offers.

**Are there any other notable risks or issues around establishing and investing in funds?**

There are no other notable risks or issues to reference here for the purposes of this site. Possible additional risks would better be assessed on a case by case basis.

**Managing and marketing debt / hedge funds**

**Are there any restrictions on marketing a fund?**

An offer of securities is generally governed by the Securities Act and [Legal Regime on Undertakings for Collective Investment in Transferable Securities](#).

Under the Securities Act, a firm is considered to market securities when an offer of securities:

- is directed at undetermined addressees;
- is preceded or accompanied by the gathering of investment intentions of undetermined addressees or marketing campaigns;
- is directed at a minimum of 150 investors; or
- is not exclusively directed to qualified investors.

Four types of entity are permitted to market funds:

- management entities;
- depositaries;
- financial intermediaries registered or authorized by the Portuguese Securities Market Commission to conduct the relevant activities, the placement, reception and transmission of orders on behalf of third parties; and
- other entities as authorized by Portuguese Securities Market Commission regulations.

Foreign funds may also be marketed in Portugal if duly authorized. Management entities authorized by another EU member state and which are subject to regulation by the relevant authority of that member state may, in principle, freely market funds under the principle of the free movement of services. Management entities not authorized by a EU member state are subject to a previous tight authorization process from Portuguese Securities Market Commission to market funds in Portugal.
Are there any restrictions on managing a fund?

Investment fund managing companies are considered financial intermediaries under the Securities Act. They must be registered with the Portuguese Securities Market Commission and are subject to rules regarding financial intermediaries.

Apart from self-managed funds (which is a possible management structure for investment companies):

- open-ended funds must be managed by investment fund managing companies (sociedades gestoras de fundos de investimento); and
- closed-ended funds must be managed by investment fund managing companies or certain credit institutions.

Investment fund managing companies must have a minimum share capital of EUR1250,000 and comply with the legal requirements governing their own funds. Credit and financial institutions that want to manage a closed-ended investment fund must hold at least €7.5 million in own funds.

Foreign management companies authorized by another EU member state and which are subject to supervision by the regulator of another member state may, in principle, freely operate in Portugal under the principle of the freedom of movement of services.

Foreign management companies from non-EU member states that wish to manage investment funds in Portugal must apply for prior authorization from Portuguese Securities Market Commission.

Investment fund managing companies are prohibited from conducting certain types of activity such as granting loans and credit, including granting guarantees, on their own account.

All investment fund management companies must act exclusively in their investors' best interests and, observe the principle of risk sharing and act according to high standards of professional competence and special diligence.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Derivatives may be traded over the counter or on an organized exchange.

Derivatives traded on an organized market are regulated according to general contractual clauses imposed by the respective fund managers. However, such contractual clauses must be subject to prior communication to the Portuguese Securities Market Commission and the prior approval of Bank of Portugal if the underlying asset of the transaction is an instrument of the money markets or foreign exchange market.

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What are common types of derivatives?

The main types of derivatives traded in Portugal are:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps);
- options (call options and put options);
- credit derivatives;
- contracts for differences; and
- caps, floors and collars.
The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Portugal are:

- transferable securities;
- monetary instruments (e.g., savings certificates, commercial paper, and cash bonds);
- interest rates (e.g., Euribor, Libor, Ester – applicable in 2020);
- foreign currency (e.g., euro/dollar and dollar/yen);
- financial ratios (e.g., PSI 20 and S&P 500);
- economic factors (e.g., inflation rates, unemployment rates, and national product); and
- other derivatives.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought in particular to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

Portuguese courts have reviewed several cases relating to derivatives since the financial crisis of 2007-to-2008. In general, Portuguese courts tend to uphold these types of agreements. However, where derivatives are traded with non-qualified investors, certain issues should be considered carefully, namely the provision of pre-contractual information, contracts subject to foreign law and usage of standard form documentation as these are issues that are considered by the courts in order to nullify or uphold such agreements.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Under Portuguese law, home mortgage loans and consumer lending are regulated activities. Only credit institutions and financial companies can carry out such credit operations and therefore the lender (credit institution or financial company) will need to be authorized by the Bank of Portugal to conduct such business.

Home mortgage loans are subject to specific rules (e.g., early repayment rules). Credit institutions have the obligation to inform consumers about the calculation of the effective interest rate (TAE), any promotional conditions and early repayment conditions.

Regulated credit agreements are subject to specific requirements regarding the terms of the agreement. Prior to the execution of a regulated credit agreement, the lender must assess the solvency of the consumer borrower.

Borrowing
While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to them, as they may benefit from the protections mentioned above.

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**What are common lending structures?**

Lending in Portugal can be structured in several different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfill certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicates taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

**Loan durations**

The duration of a loan also varies between:

- a short-term loan, with a maturity date not exceeding one year;
- a medium-term loan with a maturity date exceeding one year but not exceeding five years; or
- a long-term loan, with a maturity date exceeding five years.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, see [Giving and taking guarantees and security](#).

**Loan commitment**

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

A breach of a loan commitment will only create a contractual liability by the breaching party, which gives the innocent party the right to call for a contractual remedy or to be indemnified.

**Loan repayment**

A loan can also be repayable upon demand, on an amortizing basis (in installments during the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity. For more information, see [Lending and](#)
Do the laws recognize the principles of agency and trusts?

Portuguese law recognizes the principles under which one person or entity may act on behalf of another as attorney.

The Portuguese legal system does not recognize the concept of a trust.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. However, it is important to note that interest rates are capped by law and therefore, loans provided to institutional/professional entities are subject to the limit established for commercial interest rates which is updated every six months and is currently set at 7%.

The Legal Regime on Credit Agreements for Consumers establishes a number of requirements on lenders when dealing with consumers, including the need to:

- conduct affordability tests before lending; and
- provide standard information about a mortgage to enable borrowers to compare products.

Standard form documentation

Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house but which usually tend to follow the form of the Loan Market Association (LMA) adapted to Portuguese standards and legal requirements.

Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the Banking Act, which outlines certain measures for dealing with failing financial institutions.

The Banking Act gives the Bank of Portugal the power to ‘bail in’ obligations of failed Portuguese financial institutions. ‘Bail in’ describes a variety of write-down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Portuguese contracts, such powers override what the parties have agreed at a contractual level.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors’ powers that would be preventative. Under Portuguese law, directors have a general duty to promote the success of the company for the benefit of its members as whole; as such, they will need to be able to show
that adequate corporate benefit is derived from the company giving the guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

**Insolvency**

Guarantees and security with a determined term prior to the onset of insolvency may be at risk of being set aside under Portuguese insolvency laws. Guarantees and security might also be challenged on other grounds relating to insolvency.

**Purchase of own shares**

It is unlawful for a public company to grant loans or issue guarantees or to provide financial assistance for the purchase of its own shares (however the law expressly provides for limited exceptions).

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**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees can take different forms, as follows.

**PERFORMANCE GUARANTEE**

A third party (guarantor) personally undertakes the obligation of the debtor if the debtor fails to fulfill its obligations.

**PROMISSORY NOTE (FIANÇA)**

The guarantor promises in writing to pay a determinate sum of money to the creditor if the debtor fails to fulfill its obligations.

**Common forms of security**

There are two basic types of security interest that can be created under Portuguese law:

- a pledge; and
- a mortgage.

Different types of security are suitable for securing different types of assets (eg financial pledge and a fiduciary alienation/transfer of collateral).

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**Are there any other notable risks or issues around giving and taking guarantees and security?**

**Giving or taking guarantees**

Depending on the type of guarantee provided, specific requirements may apply. For instance, personal guarantees (fiança) need to be in writing and signed by the guarantor and the obligation guaranteed must be determined or determinable.

**Giving or taking security**

A security document may need to be executed as a deed if it contains a mortgage over land or other assets subject to registration (eg cars, airplanes and boats).

There are no notarization requirements for security documents under Portuguese law.
Like guarantees, security granted during a period of time prior to the onset of insolvency may be at risk of being set aside under Portuguese insolvency laws and may also be challenged on other grounds relating to insolvency.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Banking Act (Regime Geral das Instituições de Crédito e Sociedades Financeiras) (establishes the general regulatory framework for banks and other financial entities)

Legal Regime on Payment Institutions and Electronic Currency (DL n.º 91/2018, de 12 de novembro) (regulates the activity of payment institutions and the provision of payment services)

Securities Act (Código dos Valores Mobiliários) (establishes the general legal framework applicable to securities and to the activity of financial intermediation)

Legal Regime on the Taking-Up and Pursuit of the Business of Insurance and Reinsurance (Lei 147/2015, de 9 de setembro) (regulates access to the insurance and reinsurance business, the procedures applicable to special crimes involving the insurance sector and pension funds, as well as the administrative offences supervised by the Portuguese insurance authority Autoridade de Supervisão de Seguros e Fundos de Pensões (ASF))

Legal Regime on the Taking-Up and Pursuit of the Activity on Insurance and Reinsurance Mediation (DL n.º 144/2006, de 31 de julho) (regulates the regime applicable to insurance and reinsurance brokerage activities in the EU territory, by natural or legal persons resident or having their registered office in Portugal)

Legal Regime on Insurance Contracts (DL n.º 72/2008, de 16 de abril) (that sets out the legal framework applicable to insurance contracts)

Consumer credit


Mortgages

Legal Regime on Housing Credit (DL n.º 74-A/2017, de 23 de junho) approves the legal framework of housing credit agreements and sets out the applicable rules for consumer credit when secured by mortgage or by other types of security over real estate – partially transposes Directive 2014/17/UE relating to housing consumer credit)

Legal Regime on Mortgage Obligations and Mortgage Credit Institutions (DL n.º 59/2006, de 20 de março) (sets out the legal regime on mortgage obligations and mortgage credit institutions)

Corporations

Companies Act (Código das Sociedades Comerciais) (establishes the general legal framework applicable to the incorporation and organization of commercial companies)

Funds and platforms

Legal Regime on Undertakings for Collective Investment in Transferable Securities (Lei n.º 16/2015, de 24 de fevereiro) (partially transposes
European Directives 2011/61/EU and 2013/14/EU on collective investment undertakings and establishes framework applicable to collective investment undertakings

Legal Regime on the Setting Up and Operation of Pension Funds and Managing Entities of Pension Funds (DL n.[°] 12/2006, de 20 de janeiro) (regulates the setting up and operation of pension funds and the managing entities of pension funds)

Other key market legislation

Legal Regime on Prevention of Money Laundering and Terrorism Financing (Lei n.[°] 83/2017, de 18 de agosto)

Legal Regime on the Central Register of the Beneficial Owner (Lei n.[°] 89/2017, de 21 de agosto)

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)

Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)


Markets in Financial Instruments Regulation – MiFIR- (Regulation (EU) No 600/2014) (financial instruments)


Legal Regime on Securitisation (Lei n.[°] 69/2019, de 21 de agosto)

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Regulatory authorization

Who are the regulators?

The Bank of Portugal is responsible, among other functions, for ensuring the stability of the national financial system. To this end, it performs its functions as lender of last resort and the national macro-prudential authority. The Bank of Portugal also enacts general regulations and specific recommendations applicable to entities subject to its supervision. It also has powers to conduct investigations and apply penalties for infringement.

The Portuguese Securities Market Commission “CMVM” oversees the securities and derivatives market and is responsible for the supervision of investment services activities (known as conduct of business supervision) and the establishment of investment funds and the commercialization of units in investment funds. The Portuguese Securities Market Commission also issues general regulations and specific recommendations. It also has powers to conduct investigations and apply penalties for infringement.

The Portuguese Insurance and Pensions Funds Supervising Authority is the official body that controls and supervises the business of insurance and reinsurance, pension funds and brokerage activities.

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What are the authorization requirements and process?

Depending on the type of activity, a firm must apply to the Bank of Portugal, Portuguese Securities Market Commission or Portuguese Insurance and Pensions Funds Supervising Authority for authorization.

Bank of Portugal

The incorporation of a credit institution, financial firm (including a firm involved in the management of investment funds), payment...
institution and e-money institution is subject to prior authorization by the Bank of Portugal.

The Bank of Portugal must assess whether an authorization request meets the required threshold conditions within six months (in the case of applications for credit institutional or financial firms) or three months (in the case of payment institutions and electronic currency institutions) of submission of a completed application or submission of additional information requested (if later), provided that an assessment must be made not later than 12 months from the date of the submission of the completed application in any event.

Once authorized, the shareholders have 12 months to register the firm with the Commercial Registry.

The Bank of Portugal is also responsible for the approval of the appointment of key individuals (eg senior management, audit committee) for the supervised entities.

**Portuguese Securities Market Commission**

The Portuguese Securities Market Commission is responsible for authorizing the creation and termination of regulated markets, including multilateral trading facilities, in Portugal. The activity of fund management is also subject to registration with the Portuguese Securities Market Commission.

Credit institutions which intend to carry on investment services and financial investment activities must, following authorization by the Bank of Portugal, register with the Portuguese Securities Market Commission. The Portuguese Securities Market Commission must assess whether an application for registration meets required threshold conditions within 30 days of the date of receipt of a complete application or the submission of complementary information requested (if later). An application for registration is deemed rejected if not accepted by the Portuguese Securities Market Commission within the applicable timeframe.

Appointment of key individuals (eg senior management, audit committee) in such entities is also subject to the approval of Portuguese Securities Market Commission.

The registration fee depends on the type of application.

**Portuguese Insurance and Pensions Funds Supervising Authority**

**INSURANCE AND REINSURANCE ACTIVITY**

The incorporation of an insurance or reinsurance firm is subject to prior authorization by the Portuguese Insurance and Pensions Funds Supervising Authority. The Portuguese Insurance and Pensions Funds Supervising Authority must assess whether an application meets required threshold conditions within six months of the submission of a completed application or the submission of complementary information requested (if later), provided that such assessment must be made not more than 12 months from the date of the submission of the completed application in any event.

Once authorized, the shareholders must incorporate the firm within six months and initiate the activity for which the firm is authorized within 12 months.

**PENSION FUNDS MANAGEMENT ACTIVITY**

The activity of managing pension funds is subject to the supervision of the Portuguese Insurance and Pensions Funds Supervising Authority, who must approve the constitution of pension funds.

The Portuguese Insurance and Pensions Funds Supervising Authority must assess whether an application for approval meets the required threshold conditions within 90 days of the submission of the complete application or the submission of complementary information requested (if later).

Following authorization of a firm carrying on the activity of managing pension funds, the shareholders must incorporate such firm within six months and initiate the activity for which they have been authorized within 12 months.

**INSURANCE AND REINSURANCE MEDIATION ACTIVITY**

Both natural and legal persons domiciled in Portugal can operate the activity of insurance and reinsurance mediation provided they are registered as mediators at Portuguese Insurance and Pensions Funds Supervising Authority.

The Portuguese Insurance and Pensions Funds Supervising Authority must approve the appointment of key individuals (eg senior
What are the main ongoing compliance requirements?

Threshold conditions (including solvency requirements) are ongoing compliance requirements for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and loss of regulated status.

What are the penalties for failure to be authorized?

A person undertaking banking activity or financial investment activity without being authorized commits a very serious administrative offense and is liable for the payment of penalties, and might be subject to additional material sanctions relating to the entity or to the carrying out of the activity.

A person undertaking insurance and reinsurance activity, reinsurance mediation activity or pension fund management activity without being authorized commits a very serious administrative and/or criminal offense and may be liable for the payment of penalties and/or imprisonment, as applicable.

Regulated activities

What finance and investment activities require authorization?

Generally

Regulatory authorization is necessary for the carrying out of financial, investment and insurance and reinsurance activities in Portugal.

- Investment activities include activities such as receiving and transmitting orders regarding financial instruments, executing orders in the name of third parties, portfolio management, registering and depositing transferable securities and investment advice.
- Banking activities include activities such as accepting deposits and other repayable funds, lending, financial leasing and money broking.
- Insurance and reinsurance activities include dealing in life insurance.

Generally, financial and investment activities may only be professionally rendered by authorized credit and financial institutions. However, certain consulting activities might also be provided by other authorized individuals.

Consumer credit

Activities involving consumer credit are considered as a regulated activity. Only credit institutions and financial companies can carry out credit operations and therefore they must obtain regulatory authorization.

Issuance of means of payment and e-money

The issuance of payment instruments and e-money are regulated activities and only firms authorized by the Bank of Portugal as payment and electronic money institutions are allowed to carry out such activities.

Are there any possible exemptions?
Some financial and investment activities ordinarily requiring authorization by the applicable regulator may not be subject to authorization if certain exemptions apply. For example, financial activities carried out on a professional basis may be exempt from authorization and certain investment activities, such as companies providing investment services exclusively to their subsidiary or controlling parent entity may be exempt from authorization.

Also, activities that are merely accessory to the main activity of the entity might in some cases be provided without previous authorization.

**Do any exchange controls or other restrictions on payments apply?**

There are no legal restrictions on moving money in and out of the country. However, where money is being transferred to or from non-EU member states, in some instances sums of foreign currency above EUR10,000 must be declared to customs authorities.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

There may also be anti-money laundering and tax considerations to take into account.

**What are the rules around financial promotions?**

**Rules**

The promotion and advertising of investment and financial services is a regulated activity, unless they fall within one of the exemptions.

Promotion of investment services is considered a complementary activity to the investment service being carried out and therefore subject to the same regulatory regime applicable to such activities.

Promotion of other financial services that do not qualify as investment services may only be carried out by authorized persons/promoters, who can only carry out promotional activity provided that they do not enter into or execute agreements on behalf of the financial institution. The financial institution must draft and submit a code of conduct applicable to such promoters.

Unauthorized or unfit promotions of investment and financial services are offences punishable by fine.

**Exemptions**

Exemptions include certain promotions to certified high-net worth individuals or overseas recipients, provided certain criteria are fulfilled.

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

The most common type of legal entity are limited companies. A limited company is a corporate body with separate legal personality.

A limited company can either be a public company (denoted by the suffix SA) or a private company (denoted by the suffix Lda. or Limitada), depending on whether the identity of the shareholders is publicly known or not and on other legal aspects eg, amount and form of share capital required for constitution. Some activities require a legal entity to be used. For example, banking activity and insurance and reinsurance activity may only be carried out by public limited companies.

Members of a limited company have limited liability.
Funds

Undertakings for collective investment in transferable securities are structured as a fund or corporate body. Undertakings for collective investment structured as corporate bodies corp include (public) real estate investment companies and (public) securities investment companies and might be open or closed (to participation).

Fund managers are typically financial institutions constituted for such effect.

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes, a firm can conduct lending or investment business in Portugal through an establishment or a branch. A firm operating through an establishment or a branch will not have separate legal personality.

EU firms must notify the relevant regulator prior to establishing a branch while non-EU firms require prior authorization from the relevant regulator.

In relation to some specific activities as follows.

Credit institution, financial firm, payment institution and e-money institution

The establishment of a branch in Portugal of an EU firm is subject to prior notification by the competent regulation in the firm's home member state to the Bank of Portugal. The branches of such firms may only carry on activities in Portugal for which they have been authorized in their home member state. The establishment of a branch in Portugal of non-EU firms is subject to prior authorization by the Bank of Portugal.

Insurance and reinsurance activities

The establishment of a branch in Portugal of an EU insurance firm requires prior communication between the supervising authority in the firm's home member state and the Portuguese Insurance and Pensions Funds Supervising Authority. Non-EU insurance and reinsurance firms must obtain the prior authorization of the Portuguese Insurance and Pensions Funds Supervising Authority before establishing a branch in Portugal.

Insurance and reinsurance mediation activities

An insurance or reinsurance mediator registered in another EU member state can operate in Portugal one month after confirmation from the competent authority of its home country that it has notified the Portuguese Insurance and Pensions Funds Supervising Authority of the mediator's intention to operate in Portugal. Non-EU insurance or reinsurance mediators must obtain the prior authorization the Portuguese Insurance and Pensions Funds Supervising Authority.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal
characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Although there is still not a very active market in Portugal, marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

**Blockchain, smart contracts and cryptocurrencies**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features, such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by several nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example, relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned'). Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as
blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to decide. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings (ICOs) and token-based products

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in several jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.
Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are several applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Portuguese Securities Market Commission (Comissão do Mercado de Valores Mobiliários or CMVM) and the Bank of Portugal (Banco de Portugal or BdP) are the regulatory authorities for firms providing financial and banking products and services, respectively.

GENERAL

Regulated activities must not be carried out in Portugal without a previous authorization.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

The Bank of Portugal promotes the compliant operation of payment systems through the operation, regulation, oversight and development of payment systems and instruments. It currently operates four payment systems in Portugal:

- **SICOI** – the retail payment system that processes day-to-day payments by checks, bills of exchange, direct debits, credit transfers and bank cards;
- **TARGET2-PT** – the Portuguese component of TARGET2 (which is the Eurosystem's large value payment system);
- **AGIL** – which is the Bank of Portugal’s deposit account management system and allows institutions not participating in TARGET2 to conduct specific transactions with Bank of Portugal, namely cash deposits and withdrawals; and
- **TARGET2-Securities** – which links the Portuguese community to the Eurosystem’s securities settlement system where securities transactions are settled, notably shares and bonds against the central bank’s money.

Decree Law no. 317/2009, of 30 October and Decree-Law no 298/92, of 31 December (as amended) contain the rules applicable to payment and e-money institutions. Payment institutions and e-money institutions must obtain the Bank of Portugal's authorization prior to incorporation.

PEER-TO-PEER LENDERS

According to the Portuguese Banking Act only institutions authorized by the Bank of Portugal may carry out lending activities as a regulated activity. Peer-to-peer (P2P) lending would only be permitted if not carried out on a professional basis. Although P2P lending implies that a platform provides lending on behalf of others (investors) it is not clear if the Bank of Portugal accepts that this should not be
a lending activity on the basis that P2P lenders are not carrying out such activity by themselves, but on behalf of such investors.

**Regulation of payment services**

Where a Portuguese business provides payment services as a regular occupation or business activity in Portugal, it will require authorization by the Bank of Portugal to become an authorized payment institution under Decree-Law No 91/2018 of 12 November 2018. Failure to obtain such authorization is a criminal offence. This Decree-Law implements Payment Services Directive II.

In order to become authorized by the Bank of Portugal, a payment services business will need to meet certain criteria, including, in relation to initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

**Application of data protection and consumer laws**

The General Data Protection Regulation (GDPR) is the legal regime applicable to the protection of individuals with regard to the processing of personal data and the free movement of such data. The GDPR implements Regulation (EU) 2016/679 (General Data Protection Regulation). Whenever a business is required to process personal data in order to operate, a significant set of rules pertaining to notification and compliance obligations must be complied with.

Law no. 41/2004, of 18 August (as amended) regulates the processing of personal data and the protection of privacy in the electronic communications sector, including unsolicited direct marketing by electronic means.

The Portuguese Consumer Protection Act (CPA) was approved by Law no. 24/96, of 31 July (as amended) and provides for wide ranging protections in respect of consumers' rights, notably information rights.

**Money laundering regulations**

Law no. 83/2017, of 18 August gives the Bank of Portugal responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing other means of payment. This Law implements the European Union's Fourth Money Laundering Directive.

Where a firm is authorized and supervised by the Bank of Portugal, it will generally also be supervised for compliance with anti-money laundering requirements, particularly since electronic currencies tend to represent a higher money-laundering risk.

_Last modified 6 Dec 2019_

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

The crowdfunding sector is well established and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as PPL.

There are four types of crowdfunding in Portugal:

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Donation-based crowdfunding involves investing through a donation that may or may not have a non-monetary return.
• Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

• Loan-based crowdfunding involves the financed entity repaying the obtained financing through the payment of interest determined on the moment of the funding.

Crowdfunding offers many private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

The legal framework regarding crowdfunding has been recently approved:

CMVM Regulation on Crowdfunding (loan based and equity based) *(Regulamento da CMVM n.º 1/2016)*

Legal Framework on Crowdfunding *(Lei n.º 102/2015, de 24 de agosto)*

Sanctioning regime applicable to crowdfunding Activities *(Lei n.º 3/2018, de 9 de fevereiro)*

**ACCELERATORS**

There are various incubators or accelerators in the Portuguese market which offer support, facilities and funding for startups. Dedicated to FinTech, the most relevant accelerator in Portugal is SIBSPAYFORWARD.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund can share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

In Portugal, venture capital is the main source of funding for technological firms and startups of all sizes.

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding, which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

In Portugal, the most popular way for funding arrangements in the capital markets is by way of Initial Public Offering *(Oferta Pública de Venda)*, when a company or an investor proposes to the general public to buy certain transferable securities and wishes to trade the stocks in the stock market. However, this is not a common form of funding arrangement for growing FinTech businesses.

**Incentives and reliefs**

There are a number of investment incentive programs in Portugal in co-partnership with the European Commission, their applicability depending on the size and dimension of the applicant company, focused on stimulating economic development and competitiveness. The
most relevant investment incentive program in Portugal is Portugal 2020, and although not specifically directed to FinTech, these types of companies may be eligible, if they meet the requirements.

The Seed Initiative is designed to help small, early-stage companies raise equity finance by offering individuals who invest in the shares of qualifying startups an income tax relief of 25% of the eligible amount invested, up to 40% of the investor's Individual Income Tax, up to a maximum investment of €100,000 per year.

In addition, according to the Investment Tax Code, the activities of research and development (R&D), high-tech and information and communication technology are eligible for tax credits as an incentive designed to encourage companies to invest in those fields. Investment projects in such fields may benefit from a certain amount of tax credit (10% to 25% of the relevant applications of the investment project) in Corporate Income Tax, an exemption or reduction in Municipal Tax on Real Property and Municipal Tax on Real Estate Transfer, as well as an exemption in Stamp Tax regarding all contracts necessary for the investment project.

The Enterprise Investment and Development Tax Incentives Scheme (SIFIDE) offers a Corporate Income Tax deduction of 32.5% of the expenses incurred on research or development (and additionally the possibility to deduct 50% of the increase of expenses in R&D). In the case of micro, small and medium-sized enterprises the deduction rate applicable, in certain circumstances, is 47.5%.

Finally, the Patent Box Scheme enables companies to exclude 50% of the profits earned from its patented inventions from Corporate Income Tax, within certain limits and provided certain conditions are met.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or as a portfolio. The most common ways of selling loans are as follows.

Credits Assignment

Credits assignment is a transfer of rights only and of not obligations. Subject to any contractual restrictions, credit assignments can be done without the consent of the debtor, but the contractual relationship between the debtor and the lender will continue.

Assignment of the contractual position

An assignment of the contractual position will transfer both the rights and obligations of the lender. Although consent of the debtor is required, such an assignment terminates the contractual relationship between the debtor and the former lender.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- confidentiality – whether the seller of the loan can disclose information relating to the loan to a potential purchaser;
- data protection – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- lender eligibility – whether there are any restrictions around the type of entity to which the loan can be transferred;
- undrawn commitments – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
Projects

Financing / investing in energy / infrastructure

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Portugal varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons and housing).

Key sectors are considered below.

**Energy**

The gas and electricity industries in Portugal are privatized, with the generation, transmission, distribution and supply services provided by a number of private sector companies. The relevant private sector companies own the generation, transmission and distribution assets.

The energy sector has been a liberalized sector in Portugal since 2012, although the law has provided for a temporary transitional regulated regime. According to official data, the liberalized electricity market covered more than 4.7 million clients at the end of 2016 and both the liberalized electricity and gas tariffs amounted to approximately 91% of total electricity and gas consumption in Portugal. The transitional regulated tariffs have been decreasing over the years. **Entidade Reguladora dos Serviços Energéticos** (ERSE), the Portuguese regulator for the energy sector now only determines energy tariffs for the system tariffs (eg use of grids and infrastructures) and the transitional regulated consumer tariffs. This liberalization of consumer energy tariffs boosted free competition and the emergence of various retail energy sellers which has in turn provided a greater choice for consumers.

**Telecoms infrastructure**

The telecommunications networks (fixed and mobile) in Portugal are privately owned by a number of service providers. **Autoridade Nacional de Comunicações** (ANACOM) performs a dual role, as:

- the regulator of the Portuguese communications sector, regulating all electronic and postal communications; and
- as an independent administrative body of the Portuguese government.

**Transport infrastructure**

**Autoridade da Mobilidade e dos Transportes** (AMT) performs a dual role as:

- the regulator of the Portuguese transportation sector, supervising inland, fluvial transportation and railways, also the economic activity of trading ports and maritime transports; and
- an independent administrative body of the Portuguese government.

**LIGHT RAIL**

Typically, light rail assets (such as trams and associated tracks) are owned by local public sector promoting bodies. For example, **Carris** owns and operates the trams and supporting infrastructure in Lisbon. **Metro de Lisboa** owns and operates the metropolitan transport...
network in the Lisbon area. Outside of Lisbon there are a number of private companies operating supporting bus lines.

HEAVY RAIL

The heavy rail market in Portugal is operated by both private and public companies. Most of the Portuguese railway lines are operated by publicly owned companies, although there are some significant lines operated by private companies.

ROADS, BRIDGES AND TUNNELS

A state-owned company is responsible for designing, building, financing, exploring, preserving, requalifying and modernizing the motorways and railways across Portugal. It is supervised by the Ministry of Housing and Infrastructure and the Ministry of Finance.

PORTS AND AIRPORTS

Ports are operated by private companies.

The aviation sector is regulated by Autoridade Nacional da Aviação Civil (ANAC) and it is composed of both privately and publicly owned companies. Portuguese airports are operated by private companies, some under a concession scheme.

Other infrastructure

The majority of social infrastructure assets (schools, hospitals, defense) in Portugal are directly financed by the State of Portugal. Subject to value-for-money considerations, private finance may also be used in the procurement of social infrastructure assets.

In relation to some of these specific sectors:

EDUCATION

Education establishments may be owned by public or private entities or a mixture of the two.

HOSPITALS

Ownership of hospitals may be both public or private (or public-private partnerships). The regulatory authority for the health sector in Portugal is Entidade Reguladora da Saúde (ERS).

DEFENSE

Typically, defense assets are owned by the public sector.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in Portugal over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (e.g., merger control rules). With regard to the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered.

Energy

The energy markets in Portugal have a complex system of arrangements between suppliers, generators, transmission and distribution which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers and customer and these are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.
Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.

**Telecoms infrastructure**

The industry is largely privatized; therefore investors should consider if any permits/consents/licenses will be affected by their interest.

**Transport and other infrastructure**

Depending on the business activity, the investors should consider if any permits/consents/licenses will be affected by their interest.

**What is the applicable procurement process?**

In Portugal, public procurement is governed by the Portuguese Public Contracts Code which transposes EU directives into Portuguese law. The award of contracts by public entities must comply with the principles of the Treaty on the Functioning of the EU and in particular the free movement of goods, freedom of establishment and the freedom to provide services, as well as principles deriving therefrom, such as equal treatment, non-discrimination, mutual recognition, proportionality and transparency. In particular, for public contracts above a certain value, regulated procurement procedures with an element of competition are mandatory to ensure that those principles are given practical effect.

**Investing in energy and infrastructure**

Public procurement is relevant where the Portuguese government or a public body is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset.

A regulated procurement procedure is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run. In most cases, the awarding entity will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures:

- **Public Tender (Concurso Público)** – a procurement procedure open to any bidders; or
- **Restricted Tender by Prequalification (Concurso Limitado por Qualificação Prévia)** – a procurement procedure open to all bidders that meet requirements of technical capacity and/or financial capacity defined in the tender documents.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private-sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

**Financing energy and infrastructure**

On a publicly procured contract, the awarding entity may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project-finance deals, a refinancing of the senior debt will require the consent of the public sector.

**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**
Common forms of funding in energy and infrastructure include:

- loans made on a corporate-finance basis;
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing (this is particularly relevant in the railway sector).

**Investing**

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of ‘equity').

**Restructuring**

**Enforcement and sanctions**

**When can there be regulatory investigations?**

Under their respective supervision powers, the Bank of Portugal, the Portuguese Securities Market Commission or the Portuguese Insurance and Pensions Funds Supervising Authority may perform the necessary inspections and investigations to the entities subject to their supervision. Such investigations may result in regulatory sanctions.

**What regulatory penalties may apply?**

When a firm has committed a breach of regulation, the Bank of Portugal, the Portuguese Securities Market Commission or the Portuguese Insurance and Pensions Funds Supervising Authority may impose regulatory penalties and ancillary penalties. Penalties may include a temporary ban on a firm's operations and a publication of any penalties imposed.

**What criminal penalties may apply?**

Regulators will co-operate with competent authorities to conduct criminal investigations where appropriate. The decision of a competent authority in respect of an investigation is subsequently communicated to the relevant regulator. When an entity commits a criminal offence, it may be liable to penalties including fines or the imprisonment of responsible persons.

**Tax**
Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

The transfer or assignment of a loan triggers stamp duty only when the loan is transferred or assigned with recourse against the assignor (in the case of the borrower's default). This is on the basis that such transfer or assignment is an effective grant of credit to the assignee since the assignor retains exposure to the relevant default risk. Stamp duty is calculated on the amount of the credit and, depending on the maturity, the applicable rates are as follows:

- credit with maturity of less than one year – for each month or period – 0.04%;
- credit with maturity of one year or more – 0.50%; and
- credits used as a current account, bank overdraft or any other form of credit the period of use of which is not, or cannot be, determined – 0.04% on the monthly average balance (obtained from the sum of the balances owed calculated on a daily basis throughout the month, divided by 30).

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Portuguese stamp duty is payable on the taking of security. The applicable stamp duty is calculated based on the secured amount at the applicable rates, depending on the security's maturity, as follows:

- up to one year (for each month or period) – 0.04%;
- one year or more – 0.5%; and
- five years or more – 0.6%.

In any event, stamp duty does not apply to a security interest that is materially ancillary to a contract already subject to stamp duty and which is granted simultaneously (e.g., loan contracts).

Specific registration requirements may apply depending on the type of security interest (e.g., mortgages will only be valid if duly registered) and/or asset over which the security is taken and on the specific effects which are to be achieved (e.g., effects on third parties). Thus security interests may be subject to registration at Companies House (Registo Comercial), e.g., a pledge over shares, or at the Land Registry (Registo Predial), e.g., real estate mortgages. Registration fees apply in such cases although they are generally not material in amount.

The transfer or assignment of a security interest is not subject to stamp duty.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g., a bond)?

The issuance, transfer or assignment of a debt security does not trigger stamp duty, registration, transfer or any other similar tax.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g., secured bond holders)?
Portuguese civil law and tax procedural legislation establishes the rules for ranking creditors competing over the same asset, alongside the State Revenue, as follows:

- General preferential rights do not prevail over secured rights.
- Special preferential rights only prevail over secured rights if constituted first.
- General immovable preferential rights do not prevail over secured rights.
- Special immovable preferential rights prevail over secured rights, regardless of being constituted after those secured rights.

The State Revenue benefits from the general preferential right, and particular taxes benefit from preferential rights. Stamp duty (where the operation for which it would be levied involves real estate) and real estate transfer tax grant the State Revenue an immovable preferential right, and for that reason, tax authorities take priority on enforcement in such cases. As regards municipal property taxes, the State Revenue benefits from a special preferential right in its enforcement, only prevailing over secured rights if constituted first.

**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

In general, interest payments with a Portuguese source are subject to withholding tax in Portugal.

If so:

**What is the rate of withholding?**

The general rate of withholding tax applicable to interest payments by corporate taxpayers is 25%.

**What are the key exemptions?**

The most commonly relied on exemptions to ensure that interest payments made by Portuguese companies can be made free of Portuguese withholding tax (in whole or in part) include:

- the exemption applicable to interest received by banks and financial institutions that are resident in Portugal and subject to corporate income tax;
- the exemption applicable to interest on shareholders' loans when the lender holds, directly or indirectly, more than 10% of the share capital with voting rights in the debtor company, provided the shareholding has been held continuously during the year preceding the interest payment;
- the reliance on a double tax treaty entered into by Portugal and the country of residence of the lender to obtain an exemption (in whole or in part) provided that the requisite conditions are met; and
- the reliance on the EU Interest and Royalties Directive as implemented by Portuguese domestic law, provided that the requisite conditions are met.

**Would the same analysis apply to interest payments under a debt security (e.g., a bond)?**

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g., by virtue of incorporation, residence or local branch)?
No.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes.

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**Key contacts**

Nuno Neves  
Partner  
DLA Piper ABBC  
nuno.neves@dlapiper.com  
T: +21 358 36 27
Puerto Rico

Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Puerto Rican and US federal laws.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Puerto Rico unless an approved prospectus has been made available to the public. This prospectus needs to be approved by the Office of the Commissioner of Financial Institutions of Puerto Rico or the US Securities and Exchange Commission.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Puerto Rico are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in Puerto Rico. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities or subordinated securities;
- commercial paper (either stand-alone or as part of a program);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including interest rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features); and
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer).

What are the differences between offering debt securities to institutional/professional or other investors?

The main difference is that if the institutional/professional investor qualifies for an exemption of registration (for example, a private
placement exemption) registration of a prospectus is not required. However, a disclosure document, such as a private placement memorandum, should be used to comply with the anti-fraud provisions of the Uniform Securities Act and US securities laws.

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**When is it necessary to prepare a prospectus?**

Unless an exemption applies, it is necessary to register a prospectus with the Office of the Commissioner of Financial Institutions of Puerto Rico or the US Securities and Exchange Commission where there is an offer of securities to the public.

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**What are the main exchanges available?**

Puerto Rico does not have organized exchanges to trade securities. Securities issued in Puerto Rico or issued by Puerto Rican issuers are traded in organized exchanges in the United States such as the New York Stock Exchange and NASDAQ.

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**Is there a private placement market?**

Yes there is, but a very limited one.

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**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

All issuances of debt securities are subject to the anti-fraud provisions of the Uniform Securities Act and US securities laws.

**Investing in debt securities**

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

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**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**

The principal restriction in establishing a fund in Puerto Rico is the applicability of the Puerto Rico Investment Companies Act of 2013 or the US Investment Company Act of 1940. In addition, there are laws that regulate the establishment of certain investment funds and grant special tax treatment to the fund and investors in the fund. One such example is Act 185 that authorizes the establishment of private equity funds that do not invest in publicly traded securities and in investments in Puerto Rico.

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**What are common fund structures?**
Common forms of funds include:

- open-ended investment companies (mutual funds);
- closed-ended investment companies (mutual funds);
- private equity funds (Act 185 Funds);
- family investment funds; and
- exempt investment companies (less than 100 securities holders or all qualified purchasers under the US Investment Company Act of 1940).

What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Retail funds require the registration of a prospectus and are subject to investment requirements, prohibitions regarding leverage, limitation on transactions with affiliates and other requirements applicable to investment managers of the fund, which may not be applicable in the case of institutional funds.

Institutional/professional funds

If the institutional/professional investor qualifies for an exemption of registration (for example, a private placement exemption) registration of a prospectus is not required. However, a disclosure document, such as a private placement memorandum, should be used to comply with the anti-fraud provisions of the Uniform Securities Act and US securities laws.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Separately managed accounts are also commonly used in Puerto Rico as an investment management structure. This is where investor funds are generally held in a separate account subject to the discretionary investment authority of a manager who can acquire and dispose of assets using the investor funds in line with a pre-determined strategy and parameters set out in an Investment Management Agreement. These are often structured as common trust funds, variable annuities and individual retirement accounts.

Managing investments is a regulated activity under the Uniform Securities Act and the US investment Advisors Act of 1940 and therefore subject to authorization.

Investing in funds

Most investment funds established in Puerto Rico are created for tax reasons, and therefore the investor in the fund should be aware that the tax treatment of the investment and of the fund itself is in tune with the investor’s objectives.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

There are restrictions on offering and selling securities of a fund under both Puerto Rican and US federal laws.
Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Puerto Rico unless an approved prospectus has been made available to the public. This prospectus needs to be approved by the Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI) or the US Securities and Exchange Commission. In the case of investment companies under the Investment Companies Act of 2013 the prospectus needs to be approved by the OCFI pursuant to the disclosure requirements under such act and its accompanying regulation. The same is applicable to investment companies under the US Investment Company Act of 1940, where the prospectus needs to be approved by the SEC pursuant to the disclosure requirements under such act and its accompanying regulations.

**Are there any restrictions on managing a fund?**

Fund management in Puerto Rico is regulated under the Uniform Securities Act (PRUSA), the Investment Companies Act (Act No.6) and the Investment Companies Act of 2013. The Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI) is responsible for regulating investment companies, investment company managers, investment advisors and those marketing funds (securities broker-dealers) and any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization. The same is true with the US Securities and Exchange Commission (SEC) for investment advisors with USD100 million or more in assets under management. In that case SEC regulations supersede the PRUSA and OCFI regulations.

Various restrictions arise on manager structuring/compensation and profit-sharing arrangements as a result of the regulations and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and scope and complexity of its activities. The rules impact on, among other things, reporting and compensation arrangements.

**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

The principal issue here is whether entering into derivative contracts are transactions involving securities under the Uniform Securities Act (PRUSA). The issue of whether a commodities instrument or derivative product is a security or not is not settled in Puerto Rico and depending on the instrument they may be securities and in other cases they may not. If they are securities, the marketing or solicitation of such is regulated under the PRUSA.

Section 101 of the PRUSA states the following in this respect:

'It shall be unlawful for any person, relative to the offer, sale or purchase of any securities, directly or indirectly:

(1) to employ any device, scheme, or artifice to defraud;

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading;

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;

(4) to issue, circulate, or publish any material, printed or through electronic means, containing false representation of a material fact, or omitting information concerning a necessary material fact, so that the information which is issued, circulated or published, in the light of the circumstances in which it was issued, circulated or published, leads to an error; or

(5) to issue, circulate, or publish any material, or make any written statement, unless the name of the person who issues, circulates or publishes or makes the aforesaid, and the fact that it is that person who issues, circulates, publishes or makes the statement, is clearly indicated in that same communication.'
Section 101 of the PRUSA is applicable to any person, not just broker-dealers. Therefore it is applicable to parties to a securities transaction whether you are a broker-dealer or not. What makes section 101 of the PRUSA relevant is that the transaction is a securities transaction.

The Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI) has not interpreted whether the described commodities transactions are within the definition of securities under the PRUSA. Therefore, there is a possibility that the OCFI determines that the described commodities transactions are securities within the PRUSA and thus subject to the PRUSA including its licensing or registration requirements.

Notwithstanding the above, an entity would be not be considered a broker-dealer under the PRUSA if the person is deemed not to have a place of business in Puerto Rico and thus exempt from the licensing and registration requirements of the PRUSA. An entity does not have a place of business in Puerto Rico if:

- the person carries out transactions in Puerto Rico exclusively with or through:
  - the issuers of the securities involved in the transaction;
  - other broker-dealers;
  - banks, savings institutions, trust companies, insurance companies, investment companies as such are defined in the Investment Companies Act of Puerto Rico, pension trusts or shares in the benefit of other financial institutions or institutional buyers acting on their own account or as trustees; or
- during any other period of 12 consecutive months does not in any way make more than 15 sale or purchase offers in Puerto Rico to persons other than those specified in (A) above, whether the person making the offer or the persons to whom the offer is made are in Puerto Rico.

In addition to these issues under Puerto Rican law, the commodities market in Puerto Rico is regulated under the US Commodity Exchange Act.

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**What are common types of derivatives?**

The derivative market in Puerto Rico is very limited and are generally traded over-the-counter.

The following types of derivative contract are used in Puerto Rico:

- forwards;
- futures;
- strips (interests only strips and principal only strips);
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets.

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**Are there any other notable risks or issues around entering into derivatives contracts?**

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. In 2010, the US adopted the Dodd-Frank Wall Street Reform and Consumer Protection Act. As a result the derivatives market has seen, and continues to see, the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

With the exception of lending under the Financial Intermediary Act, lending is only a regulated activity in relation to mortgages and consumer lending (e.g. small loans, credit cards and financial leasing). In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI) to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis;
- to deal with borrowers who fall behind with their payments; and
- foreclosure procedures.

Regulated credit agreements on the other hand have specific requirements around how the agreement is drafted and formatted and what information must be included.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

What are common lending structures?

Lending in Puerto Rico can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties. Puerto Rico is a ‘freedom to contract’ jurisdiction where the parties can agree to any terms to a contract as long as such terms are not against the law and the public policy of the Commonwealth of Puerto Rico (la moral y el orden público).

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, e.g. term loans, bullet loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
• an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
• a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed.

Loan commitment

A loan can also be:
• committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity). There are regulations regarding prepayment penalty clauses that may be applicable to certain loans (for example, mortgage loans).

What are the differences between lending to institutional / professional or other borrowers?

The main difference may be that consumer credit lending is more regulated than institutional lending. However, institutional lending may be subject to specific regulations that are not applicable to consumer credit (for example, commercial property appraisals).

Do the laws recognize the principles of agency and trusts?

Although generally there is no fiduciary duty between the lender and the borrower, there are certain circumstances where the lender may be subject to liability against the borrower (for example, the exercise of unreasonable control and environmental liabilities).

Agency and trust structures are recognized under Puerto Rican law and therefore can be included in lending structures. For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. In Puerto Rico, a civil law jurisdiction, such contractual principles are found in the Puerto Rican Civil Code.

In addition, most lending is subject to credit and bankruptcy risk. In the case of insolvency, borrowers can ask for protection under the US Bankruptcy Code.

Specific types of lending

Mortgage lending is also subject to the US Real Estate Settlement Procedures Act and regulations which establishes specific requirements.
in the process of granting mortgage loans.

**Standard form documentation**

In the case of conforming mortgage loans there are standard forms for loans that can be acquired by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

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**Are there any other notable risks or issues around borrowing?**

Lending in Puerto Rico is subject to US federal consumer protection laws such as the Truth in Lending Act and subject to the regulations of the Consumer Financial Protection Bureau.

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**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**

Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

**Insolvency**

Guarantees and security may be at risk of being set aside under Federal bankruptcy laws if the guarantee or security was granted by a company with a certain period of time prior to the onset of insolvency. Insolvency proceedings in Puerto Rico are of the exclusive jurisdiction of the United States Bankruptcy Court.

**Security interest**

Puerto Rico and US states apply statutes derived from Article 9 of the Uniform Commercial Code (UCC) for constituting a security interest over personal property. Article 9 of the UCC governs security interests in personal property as collateral to secure a debt. While Article 9 does not govern security interests in real property, it does cover fixtures to real property. Security interests in real property are secured by a mortgage and governed by the Real Property Act. In order to create a security interest a security agreement must be executed. In order to perfect a security interest, generally a financing statement has to be filed at the Puerto Rico Department of State, unless it is a fixture filing, which is filed at the corresponding Real Property Registry, or a security over titled automobiles which are filed with the Puerto Rico Department of Transportation and Public Works.

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**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees can take a number of forms.

A particular distinction worth remembering is between a performance guarantee and a payment guarantee:

- A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or
perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.

- A payment guarantee is narrower in scope than a performance guarantee as it only covers the payment of money rather than other contractual obligations.

**Common forms of security**

Security interests are mostly governed by Article 9 of the Puerto Rico Uniform Commercial Code (UCC). A security interest is created by a security agreement under which the debtor grants a security interest in the debtor's property as collateral for a loan or other obligation. Depending on collateral, security interests are perfected by possession, or filing of a UCC-1 financing statement with the Puerto Rico Department of State. Security agreements may take various forms depending on the collateral.

Mortgages are perfected by filing a Deed of Mortgage with the corresponding Registry of Property. Different types of security are suitable for securing different types of assets. Fixture filings may also be filed with the relevant Registry of Property, if applicable.

Different types of security are suitable for securing different types of assets.

Under Puerto Rican law it is possible to grant security over all of the assets of a Puerto Rican company or individual assets through a combination of:

- a security interest on movable property of all types, including inventory, receivables, equipment, intellectual property etc; and
- mortgage(s) over real property(ies).

**Are there any other notable risks or issues around giving and taking guarantees and security?**

**Giving or taking guarantees**

A guarantee is a secondary obligation. In order to be valid, the primary obligation must be valid and enforceable. The guarantee itself is also subject to general contractual principles. Therefore, it must have a cause, an object and the consent of the parties.

**Giving or taking security**

A security document will need to be executed as a deed if it contains a mortgage over land.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, filing of a Uniform Commercial Code-1 (UCC-1) financing statement and notice being given to third parties. Please note, however, that perfection of a mortgage right must be made by filing a deed with the relevant Registry of Property.

Assignment of contracts, rents and leases require notarization in order to be valid against third parties under Puerto Rican law.

**Financial regulation**

**Law and regulation**

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**
Puerto Rico Banking Act (regulation of commercial banks)

Uniform Securities Act (regulation of securities broker-dealers and investment advisors) (PRUSA)

Financial Intermediary Act (regulation of lenders and financial advisors that are not regulated by special laws)

Small Loan Concessionaires Act (regulation of lenders of loans of US$5,000 or less)

Mortgage Concessionaires Act (regulation of mortgage banks)

International Financial Center Act (regulation of international financial entities)

International Banking Center Act (regulation of international banking entities)

General Credit Unions Act of 2004, as amended (regulation of Puerto Rico credit unions)

Puerto Rico Incentives Code, act 60-2019 (regulation on general tax incentives)

**Consumer credit**

Personal Property Leasing Act

Retail Instalment Sales Act (Act 68)

Small Loan Concessionaires Act (regulation of lenders of loans of US$5,000 or less)

Puerto Rico Civil Code

Puerto Rico Registry of the Property Act (regulating mortgages over real property)

Act to Regulate Mortgage Loan Industry

Act to Regulate Monetary Services Industry

**Mortgages**

Mortgage Concessionaires Act and the Puerto Rico Mortgage Law

Puerto Rico Civil Code

Puerto Rico Registry of the Property Act (regulating mortgages over real property)

**Corporations**

The General Corporations Act of 2009, as amended

**Funds and platforms**

The Investment Companies Act (Act No. 6), Investment Companies Act of 2013, as amended

**Other key market legislation**

Most, if not all, of the US federal laws regulating entities that are involved in finance and investments apply in Puerto Rico as well.

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**Regulatory authorization**
Who are the regulators?

The main financial regulator in Puerto Rico is the Office of the Commissioner of Financial Institutions of Puerto Rico. However, other financial institutions are regulated by:

- the Office of the Commissioner of Insurance (e.g. insurance companies, brokers and agencies);
- the Public Corporation for the Regulation and insurance of Cooperatives (COSSEC) (e.g. cooperatives and credit unions); and
- the Secretary of the Treasury (the main tax authority in Puerto Rico).

What are the authorization requirements and process?

Commercial banks

The entity must file with the office of the Secretary of State, a duly authenticated copy of its corporate charter or articles of incorporation and a certificate sworn to by the president, manager, agent or cashier or other authorized official of such bank, and attested to by a majority of its board of directors, stating:

- the name of said bank;
- the location of its existing or proposed main office or place of business in Puerto Rico;
- the purpose or purposes of its business;
- the amount of its paid-in capital;
- the amount of capital in cash;
- the amount of the bank's assets, including what they consist of and their cash value;
- an itemized statement of its liabilities and whether any of its debts are secured, and how they are secured; and
- the names and mailing addresses of all the directors and officials of the bank and the dates when their terms of office expire.

Foreign banks must additionally file at the same time, with the office of the Secretary of State of Puerto Rico, a certificate with the official seal of the bank and signed by the president, vice president or other acting head, and its cashier, if there is one, stating that the bank has consented to be sued in the courts of Puerto Rico in any and all causes of action originated against it in Puerto Rico and that the service of notice on the bank as defendant as well as any other judicial proceeding may be made on a given person, resident of Puerto Rico, whose name and place of residence shall be stated on the certificate; and service thus made upon the agent, shall be valid service on the bank.

The written consent of the person designated to act as agent shall also be filed, and such designation shall remain in force until a written revocation of the same is filed in said office, executed in the same manner, in which case some other person shall be designated to act as agent.

A certified copy of a designation so filed, together with a certificate stating that it has not been revoked, shall constitute presumptive evidence that the designation has been made and shall be conclusive evidence of the authority of the official making it. An investigative fee of at least USD2,500 may be applicable in the event of the establishment of a branch of a foreign bank in Puerto Rico. If the applicable fee is more than USD2,500, such excess will be notified to the applicant.

Both domestic and foreign domestic banks must have been issued a license by OCFI allowing for registration with the State Department prior to taking any of the steps set forth above.

Securities broker-dealers

The license under the Uniform Securities Act (PRUSA) is a license as a securities broker-dealer if the entity does not qualify for an exemption from registration.

A broker-dealer may register or notify its registration statement initially, or renew its registration or notice of registration statement, by
filing an application or notice before the Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI), and also giving consent to be summoned pursuant to the provisions of the PRUSA. The application or notice shall contain any information regarding the matter required by the OCFI, such as:

- the manner and place in which the applicant was organized;
- the manner in which the applicant intends to conduct business;
- the qualifications and business history of the applicant; in the case of a broker-dealer, the qualifications and history of any partner, official or director or of any person occupying a similar position or performing similar functions, or any person directly or indirectly controlling the broker-dealer;
- any injunction or administrative order or conviction for a crime involving securities or any aspect of the securities business, or any dishonest activity unrelated to the securities business; and
- the financial condition and history of the applicant.

The OCFI may, through regulation or order, require that the applicant of an initial registration publish notices relative to their application in one or more of the newspapers published in Puerto Rico, designated by the OCFI. If no denial order is in effect concerning the registration and no proceedings are pending pursuant to the PRUSA, the registration shall be effective at noon of the thirtieth day after the application has been filed. The OCFI may, through regulation or order, specify an earlier effective date and may, through an order, defer the effective date until noon of the thirtieth day after any amendment has been filed.

- Any applicant for an initial registration or renewal shall pay a filing fee of USD500 in the case of a broker-dealer or USD150 in the case of an agent. When the application is denied or withdrawn, the OCFI shall retain the total filing fee.
- The OCFI, by regulations to such effect, may require the broker-dealers to have a minimum capital or prescribe the ratio between the net capital and the total debt, subject to the limitations as established in §15 of the Securities Exchange Act of 1934.

Subject to the limitations imposed by §15 of the Securities Exchange Act of 1934, with regard to broker-dealers, the OCFI may require the broker-dealer, through regulations to such effects, to post bonds up to the sum of USD50,000, and may establish conditions. Any appropriate deposit whether in cash or securities shall be accepted in lieu of the required bond. Registered persons whose net capital, which can be defined by regulations, exceed USD100,000, or who can offer such other securities that are acceptable to the OCFI, shall not be required to post a bond. Every bond shall provide for any action under §410 of the PRUSA (Civil Liabilities), and if the OCFI thus orders it by regulation or order, by any person who may have a cause of action that does not arise from the PRUSA. Every bond shall provide that no lawsuit shall be filed to enforce any liability contracted by virtue of the bond unless the suit is filed within two years after the sale or any other act that gives rise to the suit.

- It shall be required that the broker-dealers who wish to register in Puerto Rico shall be members of the Financial Industry Regulatory Authority (FINRA), or its successor.
- The OCFI may use the services of the Central Registration Depository or any successor or similar system operated by FINRA or its affiliates, to accept registration requests, the filing of documents and the collection of fees in the name of the OCFI.

Other financial institutions

Financial institutions under the jurisdiction of the OCFI need to obtain a license under the appropriate statute that usually requires the filing of an application, information about its directors, officers and shareholders, filing fees and, in some cases, a fidelity bond.

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What are the main ongoing compliance requirements?

Commercial banks

All commercial banks in Puerto Rico are regulated by the Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI) and also have their deposits insured by the US Federal Deposit Insurance Corporation (FDIC) and as such are required to comply with the regulations of the FDIC. These essentially regulate capital, asset quality, management, earnings, liquidity and interest rate sensitivity management. In addition, special attention is given to anti-money laundering regulation and bank secrecy. Some commercial banks are also members of the US Federal Reserve System (Fed) and are subject to the Fed regulations as well.
Securities broker-dealers

Securities broker-dealers in Puerto Rico are required to become members of self-regulatory organizations such as the Financial Industry Regulatory Authority (FINRA). Most, if not all, securities broker-dealers in Puerto Rico are members of FINRA and are required to comply with its regulations. These regulations pertain to net capital requirements, communications with clients, disclosures to clients, licensing and supervision of personnel and claims, among others.

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What are the penalties for failure to be authorized?

There are civil and criminal penalties for the entity and officers and directors involved. Depending on the violation, the individuals can be barred from the industry and disqualified from obtaining licenses and authorizations in Puerto Rico.

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Regulated activities

What finance and investment activities require authorization?

Generally

The following require authorization:

- commercial banks;
- securities broker-dealers;
- investment advisors;
- financial advisors;
- lenders;
- small loan lenders;
- mortgage banks;
- credit card issuers;
- investment companies (mutual funds);
- cooperatives (credit unions);
- financial intermediaries;
- insurance companies;
- insurance brokers;
- insurance agencies;
- international insurers;
- international banking entities; and
- international financial entities.

Consumer credit

The following require authorization:
• commercial banks;
• financial intermediaries;
• lenders;
• credit unions;
• small loan lenders;
• mortgage banks; and
• credit card issuers.

Are there any possible exemptions?

Yes.

For each type of non-depository regulated activity there are a number of specific exemptions that could apply, such as *de minimis* transactions being registered under other statutes or engaging in certain transactions.

Do any exchange controls or other restrictions on payments apply?

There are no exchange controls under Puerto Rican laws as the currency in Puerto Rico is the US dollar, which is exclusively regulated at the US federal level.

What are the rules around financial promotions?

A financial promotion is a communication of an invitation or inducement to engage in investment activity (offer to sell or buy). Any such marketing of financial products, especially securities, are heavily regulated under the Uniform Securities Act (PRUSA). Pursuant to such regulation, marketing material needs to be registered and all written materials to sell securities are subject to anti-fraud protections.

Exemptions

There are a number of exemptions applicable to the registration of written marketing material to be used in the sale of securities, but there is no exemption from the anti-fraud provisions of the PRUSA and other US federal securities laws.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are corporations and limited liability companies (LLCs), both of which are legal entities with separate legal personality and limited liability with respect to their shareholders or members, as applicable.

Corporations can be private or public, depending on whether their shares are offered to the public. Corporations are usually denoted by the suffix Inc. or Corp. LLCs can also be private or public and are denoted by the suffix LLC.
The liability of a corporation's shareholders or LLC's members can be limited by shares or membership interests, in which case they are liable up to the capital contributed to the entity, but not the entity's liabilities or by guarantee, where they are also liable to pay a certain amount if the company is wound up.

LLCs are similar to corporations in many ways, with the main differences being that they are:

- not required to file public annual reports with the Puerto Rican State Department;
- not required to publicly disclose names of members;
- are allowed more flexible corporate governance structures; and
- may be taxed as partnerships or corporations.

**Funds**

Investment funds tend to take the form of limited liability companies, trusts or corporations.

Fund managers tend to be set up as limited liability companies or corporations.

**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes.

However, the branch or establishment will need the appropriate licenses to conduct business in Puerto Rico.

**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Peer-to-peer funding platforms and marketplace lending**

The FinTech marketplace in Puerto Rico is in its early stages of development. Due to the political and economic relationship between Puerto Rico and the United States (US), it is expected that developments in FinTech solutions will come as a result of evolving trends in this area from the US. As a result, Puerto Rico has not seen any local trends in financing mechanisms for marketplace lending platforms or other similar structures; the only type of emerging funding platform we are aware of is reward-based crowdfunding.

One of Puerto Rico’s economic development strategies, however, is based on transforming Puerto Rico into an attractive and successful services export hub. To this end, several tax incentive laws have been approved which provide attractive tax benefits to companies that establish their operations in Puerto Rico in order to export their services abroad. It is expected that these tax benefits will attract FinTech companies from all over the world to Puerto Rico, and these will play an active role in the development of the local marketplace in the near future.

Although commercial banks do provide limited internet banking and are starting to offer peer-to-peer payment products, financial services and products are still, generally, delivered by traditional means. Thus, generally speaking, in Puerto Rico, financial services and products continue to be provided by traditional market players, namely commercial banks, credit unions and other non-depository lending companies.
Blockchain, smart contracts and cryptocurrencies

The financial system in Puerto Rico continues to offer banking services under traditional security technology. No major developments have been observed in blockchain, smart contracts or cryptocurrencies. However, it is expected that commercial banks operating in Puerto Rico will need to enhance their offering in this area, as new technologies develop in the US and Europe.

Notwithstanding the above, the formation of International Financial Entities with cryptocurrency and digital exchange markets have been approved by the Office of the Commissioner of Financial Institutions.

Initial coin offerings (ICOs) and token-based products

There have been no ICO products introduced into Puerto Rico; however, due to its close relationship with the US markets, it is conceivable that this type of funding mechanism will be developed in Puerto Rico in the near future.

Artificial intelligence and robo advisory systems

Puerto Rico has not yet seen any developments in connection with artificial intelligence or robo advisory systems. It is anticipated that these will be introduced, as these software tools continue to develop in the US.

Data analysis and cloud computing

Cloud computing is available in Puerto Rico to support future FinTech applications that may be developed in Puerto Rico.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

As the FinTech sector in Puerto Rico is still in its early stages, there are no specific laws, regulations or procedures applicable to these products or sectors.

The Office of the Commissioner of Financial Institutions is the main regulator of the financial sector in Puerto Rico. Other financial institutions, such as insurance companies, are regulated by the Office of the Commissioner of Insurance. The credit unions are regulated by the Public Corporation for the Regulation and Insurance of Cooperatives.

Commercial banks in Puerto Rico are also part of the US banking regulatory system inasmuch as the deposits of all such institutions are insured by the Federal Deposit Insurance Corporation. As a result, commercial banks in Puerto Rico are subject to laws and regulations applicable to banks in the US and are supervised by the applicable US supervisory agency, as well as by the local regulator. Therefore, it is anticipated that the local regulatory environment in Puerto Rico will be developed in line with the US regulatory system as financial innovation continues its dynamic growth.

FinTech companies looking to conduct business in Puerto Rico, must ensure compliance with the applicable local laws including licensing requirements for the conduct of banking business, as well as with any consumer lending, securities and insurance laws and regulations applicable to any such activities.

Electronic payments platforms and regulation of peer-to-peer lenders

There are no specific laws or regulations in Puerto Rico that regulate electronic payment platforms or peer-to-peer lending.

Regulation of payment services

Payment services in Puerto Rico are generally controlled by commercial banks and credit unions. There are other important players in this market such as the money services businesses. Under the Money Services Business Regulatory Act (MSBRA) any entity that proposes to conduct a money services business in Puerto Rico must obtain a license from the Office of the Commissioner of Financial Institutions. The MSBRA covers entities that provide money transfer services, check cashing services and money order services, as a regular business in
Puerto Rico. The MSBRA provides certain minimum capital and liquid assets requirements and incorporates by reference all US federal anti-money laundering laws and regulations.

Application of data protection and consumer laws

There is no single law in Puerto Rico that provides a comprehensive treatment of data protection or privacy issues. There are, however, several applicable local and US federal laws and regulations related to the protection of consumer information, including privacy and security, most of which are focused on the protection of non-public information about consumers by financial institutions.

The Citizens Information of Data Banks Security Act (DBSA) makes it mandatory to notify the Puerto Rico Consumers Affairs Department (DACO) in the event of a data breach within ten days of detection. Upon receiving notice, DACO may make the breach public within 24 hours.

A data breach is defined in the DBSA as any incident in which personal information is accessed in such a way that the security or confidentiality of the data is compromised, regardless of whether the personal information is accessed with or without permission, or under false pretenses. If a breach is suspected to involve criminal activity, the DBSA recognizes the need to delay notification and allow for enforcement agencies to conduct an investigation and prevent evidence from being destroyed, lost or altered.

There are two exceptions for providing a data breach notification under the DBSA. The first is where the data is protected by encrypted or other technical controls (in that case, the incident might not be considered a data breach). Second, if the breached entity already provides for a data breach notification procedure as a part of its own information security policies, that affords individuals equal or greater protection. The DBSA provides various options for the notification and also sets forth certain basic information that must be included.

The Consumer Personal Information Destruction Act (CPIDA) requires commercial entities to securely destroy any data or records that contain personally identifying information. All documents must be shredded, or the information must be suppressed or modified so as to render it illegible or unidentifiable. The CPIDA does not address or specify what reasonable safeguards or appropriate security measures should be employed in order to properly dispose of electronic material. The destruction of information must be documented via a notarial act and preserved for a period of ten years.

Title V of the federal Gramm-Leach-Bliley Act and regulations issued thereunder, require financial institutions, generally defined as companies that offer consumer financial products or services, to:

- explain to their customers their information sharing practices;
- safeguard customers' sensitive data; and
- give consumers the option to opt-out of some sharing of personal financial institutions (in this respect, customers must be notified, on a periodic basis, of the financial institution's Privacy Policy and must be given the option to opt-out of the customer's personal information sharing).

The Notification of Privacy Policies Act (NPPA) imposes on every website operator and any person who collects personal information, the duty to notify its users of its information sharing policies and practices in a clear, concise and conspicuous manner. Furthermore, the NPPA requires that website operators inform individuals of their rights, if any, to access or rectify their personal information and the procedures for obtaining notice when the privacy notice is revised.

Money laundering regulations

The US federal anti-money laundering (AML) laws and regulations are applicable in Puerto Rico to the same extent as they apply to any state of the US. Specifically, the Bank Secrecy Act (BSA) provides a comprehensive set of rules that must be complied with by financial institutions that conduct business in the US and its territories (such as Puerto Rico), designed to assist the US government agencies in detecting and preventing money laundering. Generally, the BSA and its implementing regulations require, among others, the establishment by covered financial institutions of specific AML programs as well as know-your-customer programs. Under such programs, covered financial institutions are generally required to identify and report transactions of a suspicious nature to the Financial Institutions Crime Enforcement Network and the Office of Foreign Asset Control, agencies of the US Treasury Department. Further, financial institutions are required to verify customer identity and understand the kinds of transactions in which the customer is likely to engage. Moreover, there are reporting obligations regarding cash transactions in excess of USD10,000 received by covered transactions.

In addition to the BSA, Section 60501(a) of Title 26 of the US Internal Revenue Code (the Code) generally provides that any person engaged in trade or business who receives more than USD10,000 in cash in a single transaction or in related transactions must file a
What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

**SEED INVESTMENT**

Since FinTech has yet to develop in Puerto Rico, we are not aware of any funding arrangements or incentives specifically targeted at this sector. There are, however, funding mechanisms available for startups or innovative businesses more generally, addressed below. Initial investment in startup businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

Grupo Guayacan, a non-profit dedicated to promoting entrepreneurship, has recently launched a fund to invest seed capital in startups.

**CROWDFUNDING**

Crowdfunding may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Kickstarter.

There are two main types of crowdfunding: equity and reward-based.

- **Equity crowdfunding involves company shares being given in exchange for investment in the business.**
- **Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.**

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

To our knowledge, there is no equity crowdfunding platform specifically geared to Puerto Rico businesses; however, as Puerto Rico is part of the US, US-based platforms are available and have been used by local businesses. We know of one local reward-based crowdfunding platform, Antrocket, although it appears to be currently inactive. As with equity crowdfunding platforms, reward-based crowdfunding platforms based in the US are available for local businesses.

**ACCELERATORS**

There are various incubators or accelerators in Puerto Rico which offer support, facilities and funding for startups, sometimes in return for an equity stake. The most well-known is Parallel18, which is a program of the Puerto Rico Science, Technology and Research Trust which offers cash grants, together with mentoring from industry experts. Several municipalities, including Caguas and Mayaguez, also operate incubators/accelerators. In addition, there are several business plan competitions in Puerto Rico which also provide cash grants and mentoring. The best-known is called EnterPRize and is run by Grupo Guayacan.

**Venture capital and debt**

Venture capital (VC) funding is a type of equity investment usually targeted at early stage companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset report with the US Internal Revenue Service. The Code provides certain exceptions to the general rule stated above, such as:

- cash received by a financial institution; and
- transactions occurring outside of the US (which includes Puerto Rico).

Finally, Act No. 131 of July 23, 1974, as amended (Act 131) is the most relevant locally enacted AML statute. Act 131 requires domestic financial institutions covered to report to the local Treasury Department any wire transfer of funds in excess of USD5,000 that is initiated to or received from a foreign country.

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base or long track record needed to attract traditional debt funding from financial institutions. 

There are a few VC funds in Puerto Rico. The best-known is Advent-Morro. 

To our knowledge, venture debt is not available in Puerto Rico. 

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator. Warehouse financing is unusual in Puerto Rico, except in the context of commercial and residential mortgages. It is sometimes seen in subsidiaries of large companies, as part of a broader US or global financing. Asset based loan financing by banks is somewhat more common.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead interest is paid on the money borrowed. We are not aware of any local P2P lending platforms, but local businesses have access to US P2P lending platforms. 

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes. Bank debt is the most common financing method in Puerto Rico, as the local banking sector is robust and sophisticated.

**CAPITAL MARKETS FUNDING**

Puerto Rico has no equity capital markets. The US equity capital markets are accessible to Puerto Rican businesses, but most Puerto Rican businesses are too small to make this a viable financing alternative. Currently, there are only a handful of publicly listed Puerto Rico-based companies (principally banks and insurance companies).

Puerto Rico has private debt markets (mainly bonds and notes), although these have been significantly reduced as a result of the current financial crisis. In the past, companies issued industrial revenue bonds (known as AFICAs) and banks issued preferred debt. There have also been private placements of debt by hotel and resort companies, a private toll road, the operator of the airport and certain conduit offerings, all of which are sizeable businesses.

**CONVERTIBLE BONDS/LOAN NOTES**

Convertible bonds or loan notes are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances. Convertible bonds are not all that common in Puerto Rico.

**Incentives and reliefs**

Puerto Rico's new Incentives Code became law on 1 July 2019. The Incentives Code effectively consolidates all tax incentives available for different economic activities into a single legislative measure, including export services businesses ("ESBs") previously covered under Act No. 20-2012, the Act to Promote the Exportation of Services (APES), as well as private equity funds ("PEFs") previously covered under Act No. 185-2014, the Private Equity Funds Act (PEFA).

The Incentives Code promotes the establishment of ESBs in Puerto Rico by granting tax incentives for exporting services from Puerto Rico to persons outside of Puerto Rico with no nexus to Puerto Rico. Among the export services covered by the Incentives Code are (collectively, "ESB Eligible Activities"):

- blockchain and cloud-computing services;
research and development;

advertisement and public relations;

consulting;

investment banking, asset management and other financial services; and

professional services such as legal, accounting, architectural and engineering services, among others.

In general, qualifying ESBs must file an application with and obtain a tax decree from the Department of Economic Development and Commerce (DDEC, for its Spanish acronym) (“ESB Decree”) to receive the following tax benefits:

- a 15-year binding contract with the government of Puerto Rico, which means that the constitutional prohibition against the impairment of contracts should protect the awarded tax benefits from any potential revocation or amendment by subsequent legislation;

- a 4% income tax rate on the net income derived from the ESB Eligible Activities covered by the ESB Decree;

- no income tax on dividend distributions the ESB makes out of its earnings and profits derived from the APES Eligible Activities;

- a 50% exemption from municipal license taxes on the volume of business derived from the ESB Eligible Activities; and

- a 75% exemption from real and personal property taxes with respect to property used in the ESB Eligible Activities.

The Incentives Code has two aims with respect to PEFs: to promote investment in entities that do not have access to public capital markets and to attract capital investments in Puerto Rico.

In general, the Incentives Code provides that any limited liability company or partnerships (domestic or foreign) engaged in the business of investing in such instruments or notes, bonds, or stock (not traded or quoted in public markets when acquired) may file an application with the DDEC to be treated as a PEFs, subject to certain conditions. Among other requirements, this limited liability company or partnership must have an office in Puerto Rico and must enter into a contract with a registered investment advisor who is engaged in trade or business in Puerto Rico, which may subcontract another investment advisor that is located outside Puerto Rico. In addition, the Incentives Code provides that a series limited liability company (LLC) may elect to be treated as a single “private equity fund,” regardless of the number of series. The Incentives Code also provides that securities issued by the government of Puerto Rico are eligible investments for purposes of the minimum investment in Puerto Rico securities requirements. Finally, the diversification threshold for investing in a single business is 50%.

Under the Incentives Code, a qualifying PEF must file an application with and obtain a tax exemption grant from the DDEC, the content and specifications of this application of which are not yet available, to receive the following tax incentives:

- The PEF is treated as a partnership for Puerto Rico income tax purposes. Accordingly, a PEF is not subject to Puerto Rico income tax; instead, the investors are subject to Puerto Rico income tax with respect to their distributive share of the income of the PEF.

- The share of an accredited investor of dividends and interest derived by the PEF is subject to a Puerto Rico fixed income tax rate of 10%. Nevertheless, interest or dividend income derived by the PEF and that is exempt from Puerto Rico income tax is also exempt for the accredited investors.

- An accredited investor’s share of capital gains derived by a PEF is exempt from Puerto Rico income tax.

- Capital gains from the sale of the private equity fund interest are subject to a Puerto Rico fixed income tax rate of 5%. However, if total gross proceeds are reinvested in a Puerto Rico private equity fund within 90 days from the date of the sale, such capital gains are not subject to Puerto Rico income tax.

- In the case of registered investment advisors, general partners and private equity firms, interest and dividend income is subject to a Puerto Rico income tax rate of 5% and capital gains are subject to a 2.5% tax rate.

- A 30% or 60% deduction with respect to the initial investment in the PEF, provided certain rules are met and a 75% exemption on real and personal property taxes and 100% exemption on municipal license taxes; however, property such as stock, bonds, notes, promissory notes and other securities or debt instruments in which a PEF invests is exempt property under the Municipal Property Tax Act of 1991, as amended, and is not otherwise subject to Puerto Rico personal property taxes.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are through the purchase of asset and liabilities agreements and servicing agreements. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **servicing obligations and fees** – a sale of a pool of loans is usually subject to servicing and servicing fees;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in Puerto Rico varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (e.g. energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (e.g. education, health and justice/prisons, and housing).

Key sectors are considered below.

Energy
Energy in Puerto Rico is principally generated by the Puerto Rico Electric Power Authority (PREPA), a government instrumentality of the Commonwealth of Puerto Rico. PREPA is the largest public utility in the US. Given the financial challenges facing PREPA, including the looming default of its debt obligations and its restructuring, the government has issued a request for proposals (RFPs) for the privatization of the transmission of energy and is scheduled to issue and RFP for generation of electricity in the first quarter of 2020.

Telecoms infrastructure

Currently, the Puerto Rico Telephone Company (PRTC), the principal provider of telephone services in Puerto Rico, is privately owned by America Movil from Mexico (a company owned by Carlos Slim). At one moment in time, the Commonwealth of Puerto Rico owned and controlled the PRTC but later sold it to GTE/Verizon, who later sold it to America Movil. There are other telephone services providers in Puerto Rico, but all are currently private. There are plans for a subsidiary of PREPA to offer telephone and internet services through PREPA Net, but that service is not up and running in the public market yet.

Transport infrastructure

The main airport in Puerto Rico, the Luis Muñoz Marín International Airport (LMM Airport), was leased for a term of 40 years to Aerostar Airport Holdings, LLC through a public-private partnership (P3) on 26 February 2013. Aerostar is a private operator of the airport and is a venture from Mexico (60% ASUR) and Canada (40% Public Pensions Plans of Canada). All other port facilities, including other regional airports and maritime ports are government owned. The Commonwealth of Puerto Rico has indicated that they will be issuing RFPs for P3 projects related to the regional airports and the maritime ports.

Similarly to what happened to the LMM Airport, the Puerto Rico Highways and Transportation Authority entered into an Operation and Maintenance Agreement with Metropistas de Puerto Rico related to the PR-22 and PR-5 highways in the north of Puerto Rico. Metropistas is a joint venture between Goldman Sachs & Co. and Abertis from Spain. In addition to this P3, the Teodoro Moscoso Bridge is also operated by an affiliate of Abertis. The rest of the highway and transportation network in Puerto Rico is publicly owned and operated. The Commonwealth of Puerto Rico has indicated that they will be issuing RFPs for P3 projects related to the highways and transportation infrastructure.

Other infrastructure

All other economic infrastructure is owned and operated by the government government (subject to ongoing negotiations with private parties to operate (i) Puerto Rico's regional airports and ferry systems and (ii) the San Juan Cruise Terminal). Social infrastructure is a mixture of government and privately owned and operated projects.

Are there special rules for investing in energy and infrastructure?

Since the Commonwealth of Puerto Rico no longer has access to the world capital markets, the government is relying on public-private partnerships (P3) to put forward energy and infrastructure projects. Therefore investing in these projects is through the procurement of P3 projects. That procurement is pursuant to the Puerto Rico Public-Private Partnership Act of 2009, as amended (P3 Act). The P3 Act expressly states that it is the public policy of the Commonwealth of Puerto Rico to favor and promote the establishment of P3s and further authorizes all departments, agencies, public corporations, and instrumentalities, as well as municipalities and the legislative and judicial branches of the Commonwealth of Puerto Rico, to use the establishment of P3s in accordance with the process specified therein. The P3 Act also establishes that the Commonwealth of Puerto Rico shall not legislate to limit the powers or rights granted to the Puerto Rico Public-Private Partnership Authority (Authority) and partnering government entities under the P3 Act until the obligations under an executed P3 contract are satisfied. The P3 Act also sets out the areas where P3s are expressly authorized as a matter of policy. These are defined as ‘Priority Projects.’

The Priority Projects are:

- the development, construction or operation of sanitary landfill systems, including methane recovery operations, as well as facilities for the management and disposal of non-hazardous and hazardous solid waste, such as plants for recycling, composting and converting waste into energy;
- the construction, operation or maintenance of reservoirs and dams, including any infrastructure necessary for their operation to produce, treat, and distribute water and any infrastructure for the production of hydroelectric energy and for sewage and potable
water treatment plants;

- the construction, operation or maintenance of existing or new plants for the production of energy;
- the construction operation or maintenance of transportation systems of any kind, thorough a fare system or related infrastructure;
- the construction, operation or maintenance of educational, health, security, correctional and rehabilitation facilities. It is worth noting that when operating educational facilities, a P3 may only be established if the contract is executed with a worker-owned cooperative, a special employee-owned corporation or a nonprofit entity;
- the construction, operation or maintenance of affordable housing projects;
- the construction, operation or maintenance of sports, recreational, tourist and cultural entertainment facilities;
- the construction, operation or maintenance of wired or wireless communication networks for communications infrastructure of any kind;
- the design, construction, operation or maintenance of high technology, computer and automation systems; and
- the construction, operation or maintenance of any kind of activity or facility or service as may be identified from time to time as a Priority Project through legislation.

Legal framework

The existence of the P3 Act and its regulation provide clarity, uniformity, and boundaries to the P3 selection process and contracting, underscoring the strength of Puerto Rico as a jurisdiction with certainty with respect to the legal framework for the development of P3s. Of particular significance are the following aspects of the P3 Act and Puerto Rico's legal system.

P3 CONTRACTS

The P3 Act broadly allows for creation of P3s, providing that P3 contracts may be design-build; design-build-operate; design-build-finance-operate; design-build-transfer-operate; design-build-operate-transfer; turnkey; long-term lease; surface right; administrative grant; joint venture; long-term administration and operation; and/or any other kind of agreement that separates or combines the design, building, financing, operation or maintenance phases of the so called Priority Projects. Furthermore, the P3 Act is clear about certain required clauses in a P3 contract, possible clauses to be negotiated between the parties and boundaries with respect to other clauses. The P3 Act even discusses the issue of the possible transfer of public employees to the P3 entity when the government partner benefitting from the P3 is in a precarious fiscal condition. The P3 contracts may have an initial maximum term of 50 years and may be extended for an additional 25 years (75 years total) provided certain conditions are met.

CONFIDENTIALITY

The P3 Act establishes a balance between information that has to be disclosed publicly and confidential information. It provides for ways of protecting certain privileged or protected information disclosed by proponents to the Authority as a part of the P3 procurement process. The proponents shall have the duty of identifying the information that the proponent considers confidential and, when presenting the proposal, request confidential treatment. The Authority will evaluate the requested confidential treatment in accordance with the procedure established in the P3 Act and in the Regulation and then make a determination regarding the same; if it constitutes a trade secret, proprietary information or privileged/confidential information, all such information shall be protected. Also, Act 80 of 2011, known as the Trade Secrets Act of Puerto Rico, follows the Uniform Trade Secrets Act which classifies a trade secret as any confidential information that has economic value or that provides commercial advantage and is under reasonable security measures.

TAXES

The P3 Act provides property tax exemptions for facilities subject to a P3 contract and any property used exclusively in, or for, the facility subject to the P3 contract if it is acquired, built or owned by the partnering government entity and is made available to the operator. The private partner may enter into agreements with municipalities to establish exemptions from municipal license fees, excise taxes or municipal taxes. In addition, the private partner, whether classified as a corporation or as flow-through entity for PR income tax purposes, is subject to a fixed preferential income tax rate of 1020% over the net income derived from the operations provided in the P3 contract, in lieu of any other income taxes imposed by the PR Internal Revenue Code of 2011, as amended ("PR-IRC"). Distributions of the net profits derived from the operations provided in the P3 contract to the shareholders, members or partners, as the case may be, of the private partner are not subject to further taxation in Puerto Rico.
What is the applicable procurement process?

Once the Puerto Rico Public-Private Partnership Authority (Authority) has determined that the project meets the public policy requirements of the P3 Act and it is advisable to pursue the establishment of a public-private partnership (P3), then the P3 Act provides for two kinds of procurement procedures:

- competitive negotiated procurement; and
- negotiations without a request for proposal.

The P3 Act also provides for unsolicited proposals. The first procurement procedure involves request for qualifications (RFQ) issued by the Authority to identify the persons that satisfy the minimum standards to enter into a P3 contract. The P3 Act describes the qualifications to be a proponent. Among these qualifications, a proponent must:

- be authorized to do business in the Commonwealth of Puerto Rico;
- have available corporate or equity capital or securities or other financial resources that are necessary for the construction and proper operation, as applicable, of the P3;
- have a good reputation;
- have technical capacity and experience; and
- certify that neither it nor any of its directors or officers have formally been convicted for acts of corruption in Puerto Rico, the US or any foreign country.

Proponents may present proposals jointly under consortia. After the RFQ process, requests for proposals (RFPs) will be issued. Proponents who submit proposals for P3 contracts shall assume the risk of paying for all expenses related to the RFQ and RFP processes.

The second procedure is initiated by the Authority and allows the negotiation of a partnership contract without abiding by the RFQ and RFP procedure only when:

- there is only one source capable of providing the service required; and
- an RFP was issued and received no responses or the proposals submitted failed to meet the indicated requirements, and, in the Authority's opinion, issuing a new RFQ and RFP would cause such delay that a partnership contract may not be executed in the time required.

Prior to executing a contract with proponents chosen pursuant to this second procurement alternative, the Authority must notify the legislature Public-Private Partnership Joint Commission. Unsolicited proposals are also provided for under the P3 Act.

Unsolicited proposals may be received by the Authority provided they include, at a minimum:

- a summary of the proposed project;
- a description of how the proposed project satisfies a government need;
- how the proposal differs from other traditional or proposed approaches to develop the project;
- the amount of public resources needed to complete the project and indirect and direct costs involved, including capital costs;
- financial viability and financing mechanisms available;
- commercial aspects of the project;
- possible public benefit;
- proposed method of execution; and
- unique intellectual property involved, if any.

If the Authority considers the unsolicited proposal to be favorable to the public interest, it may either enter into talks directly with the
unsolicited proponent or commence a process of open RFP, depending on various conditions indicated in the P3 Act.

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What are the most common forms of funding / investing in energy and infrastructure?

Funding

In the past the principal source of funding for energy and infrastructure projects was through the issuance of municipal bonds by instrumentalities of the Commonwealth of Puerto Rico such as the Puerto Rico Electric Power Authority. Given the financial challenges of the government sector in Puerto Rico and the lack of access to the world capital markets, the shift has been to financing projects through public-private partnerships (P3s) (brownfields and greenfields).

Investing

Since the government is relying almost exclusively on P3s, there are investment opportunities for infrastructure funds and similar investors and lenders to such investors.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Office of the Commissioner of Financial Institutions considers that a regulated company or individual may have breached the ongoing compliance requirements or that an unregulated person carries out regulated activities, it can launch an investigation which may result in fines or penalties.

What regulatory penalties may apply?

When a regulatory breach has taken place, the Office of the Commissioner of Financial Institutions of Puerto Rico may impose a fine or penalty, or revoke the license to operate in Puerto Rico. These penalties are published in the applicable regulations.

What criminal penalties may apply?

Criminal penalties may apply to the extent that the Puerto Rican Criminal Code is violated or if US federal laws are violated. Generally, this occurs in cases of insider trading, material misstatements, money laundering, and when carrying out regulated activities without authorization.

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?
Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer of assignment of a loan?

No.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture of other security?

No.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

No.

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**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

With respect to real property taxes, the Puerto Rico Municipal Revenue Collection Center (known as CRIM for its Spanish acronym) has a preferential lien, which has priority over any other lien. The lien is limited to real property taxes owed for the current fiscal year and the previous five fiscal years.

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**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Generally, there is no income tax withholding on interest payments made to any Puerto Rico entity. Similarly, there is no income tax withholding on interest payments made to a foreign entity, unless:

- the creditor is a foreign entity not engaged in a trade or business in Puerto Rico; and
- the debtor and creditor are 'related persons' under the Puerto Rico Internal Revenue Code of 2011, as amended.

If so:
What is the rate of withholding?

Where applicable, the rate of withholding is 29%.

What are the key exemptions?

As indicated above, interest payments made to any Puerto Rico entity are not subject to income tax withholding and interest payments made to a foreign entity are not subject to income tax withholding if the foreign entity is not a 'related person' with respect to the debtor. Other exemptions exist for interest paid to foreign entities that are otherwise 'related persons' for interest paid on bank deposits and interest paid by international banking entities. There are no tax treaties between Puerto Rico and other jurisdictions.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

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Are foreign lenders and debt security holders subject to tax on interest payments?

In general, foreign lenders and foreign debt security holders not engaged in a trade or business in Puerto Rico are not subject to Puerto Rico income tax on interest payments, unless they fall within the definition of 'related persons' of the Puerto Rico Internal Revenue Code of 2011, as amended.

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Key contacts

Nikos Buxeda
Managing Partner
DLA Piper (Puerto Rico) LLC
nikos.buxeda@dlapiper.com
T: +1 787 945 9114
Romania

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Romanian and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Romania or to request that they are admitted to trading on a regulated market operating in Romania unless a prospectus approved by the Financial Supervisory Authority has been made available to the public.

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What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Romania are bonds or notes issued on a stand-alone basis or under a program.

Common forms of debt securities offered in Romania include:

- government bonds and treasury certificates;
- municipal bonds;
- corporate bonds;
- exchangeable bonds (debt securities convertible into the equity of a third party); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

In addition, following the enactment of Law No 304/2015 which entered into force on March 2016, a new legislative framework was established in order to facilitate the issuance of mortgage covered bonds by credit institutions.

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What are the differences between offering debt securities to institutional / professional or other investors?

The preparation and publishing of a prospectus are not mandatory for an offer of securities addressed solely to professional investors.

Professional investors are defined as clients who have the experience, knowledge and ability required to take investment decisions and assess the risks involved, and include, inter alios, the following:
When is it necessary to prepare a prospectus?

Under Romanian law, unless an exemption applies, it is necessary to publish a prospectus approved by the Financial Supervisory Authority where there is an offer of securities to the public.

Certain exemptions where the preparation and publishing of a prospectus are not mandatory apply, such as, inter alios, the following:

- an offer of securities addressed solely to qualified investors;
- an offer of securities addressed to less than 150 investors, natural or legal persons, other than qualified investors, per member state of the EU;
- an offer of securities addressed to investors who each acquire securities of at least the equivalent in RON of €100,000 for each separate offer;
- an offer of securities whose nominal value per unit amounts to at least the RON equivalent of €100,000; and
- an offer of securities whose total value in the EU is less than the equivalent in RON of €100,000, calculated over a period of 12 months.

Even if the offer is exempted from the prospectus requirement, as a general rule a prospectus is still required if an application is made for the securities to be admitted to trading on a regulated market.

What are the main exchanges available?

The Bucharest Stock Exchange

The Bucharest Stock Exchange is authorized by the Financial Supervisory Authority (FSA) as a market operator and, as such, it manages a spot regulated market.

The Bucharest Stock Exchange is also authorized by the FSA as a system operator. In this capacity, it operates an Alternative Trading System (Multilateral Trading Facility).

Is there a private placement market?
Romania has a low-volume private placement market.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Making a public offer without the Financial Supervisory Authority's approval of the prospectus, when no exemption applies, constitutes an administrative offense.

Issuers are required to take responsibility for prospectuses for debt securities.

Misleading statements in, or omissions from, any applicable offering document may give rise to civil and, under certain circumstances and mainly in case of willful misconduct, criminal liability.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

In order to comply with the Romanian legislation, investment vehicles must be established in accordance with the following conditions.

Undertakings for Collective Investments In Transferable Securities (UCITS)

UCITS for which Romania is home member state, may only operate based on the authorization issued by the Financial Supervisory Authority (FSA).

The FSA authorization shall not be issued in case:

• the persons who effectively manage the fund do not have the reputation or necessary experience to perform activities which are specific to a certain type of UCITS; or
• the UCITS is restricted by law (including by inserting a provision in the rules of the fund or in the articles of association of the company) to distribute all the participation titles on the territory of Romania.

Open-ended investment funds

The initiative for setting up an open-ended investment fund belongs exclusively to the investment management company, in accordance with the decision of the board.

Open-ended investment funds are managed by an investment management company. Therefore, a prerequisite for obtaining a license from the FSA is to have a license for the investment management company or the consent of the FSA with regards to an investment management company's request from a member state to manage the respective investment fund.

Open-ended investment companies

Open-ended investment companies must be licensed by the FSA (the licensing requirements for open-ended investment funds are also applicable to open-ended investment companies). Such companies may be managed either by their board of directors or by a separate investment management company.

Open-ended investment companies may not perform other activities than:

• operating collective investments by placing financial resources in financial instruments (as provided by law) based on the risk diversification and prudent administration principle; and
ensuring that the value of the titles for participation on a market does not vary significantly in relation to the value of the net unit asset.

The initial capital of investment companies managed by their board of directors must amount to at least the RON equivalent of €300,000.

Open-ended investment companies must request the trading admission on a regulated market within 90 days from the issuance of the FSA authorization.

**Alternative Investment Funds (AIFs)**

Each AIF is administered by an AIF manager (AIFM) which may be an external manager. In case the AIF is self-administered, the provisions related to AIFMs are also applicable.

The AIFM must fulfil the following requirements:

- it must be authorized by the FSA; and
- in order to be authorized:
  - the AIFM must have initial share capital and sufficient own funds in accordance with the law;
  - the persons who effectively manage the AIFM must have the reputation or necessary experience as required by the FSA;
  - the day-to-day management must be ensured by at least two persons meeting such conditions;
  - the AIFM shareholders that have qualifying holdings must meet the requirements of the need to ensure sound and prudent management of the AIFM; and
  - the head office and registered office of the AIFM must be located in Romania.

**What are common fund structures?**

Common forms of funds include:

- Undertakings for Collective Investments In Transferable Securities;
- Alternative Investment Funds; and
- financial investment companies.

**What are the differences between offering fund securities to professional / institutional or other investors?**

Participative titles issued by Alternative Investment Funds (AIFs) which are authorized in other member states can be offered to retail investors in Romania only if those AIFs observe the conditions of the investment limits and reporting, transparency and publicity requirements currently applicable to Other Collective Investment Undertakings (OCIUs) which attract financial resources publicly.

In addition to such conditions, participative titles which are issued by AIFs authorized in other member states and which may be offered to Romanian professional investors, may be distributed to Romanian retail investors only if the entities which perform the distribution are authorized to provide investment advisory services.

**Are there any other notable risks or issues around establishing and investing in funds?**

There are no specific risks except for the inherent risks corresponding to each type of fund.
Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Undertakings for Collective Investments In Transferable Securities (UCITS)

In the case of UCITs, marketing materials addressed to investors can only be made public following the approval by the Financial Supervisory Authority (FSA) of the prospectus and its publication.

UCITS authorized in an EU member state intending to market in Romania must complete and submit to its home regulator a notification including certain specified documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in Romania.

Alternative Investment Funds (AIFs)

AIFs which are closed-ended investment funds attracting financial resources publicly can be marketed to the public following their registration with the FSA and following the FSA's approval.

Closed-ended investment funds which attract financial resources privately and are managed by an AIFM are not allowed to distribute any promotional materials to the public.

An AIFM authorized in an EU member state may distribute and market AIFs from an EU member state in Romania to professional investors on the basis of its authorization by the relevant EU member state regulator, under an EU passport. The distribution of participative titles in AIFs, as well as the marketing of those AIFs in Romania are subject to the passporting formalities which mainly require that the FSA is notified by the AIFM home member state regulator of the intention of the AIFM to distribute in Romania participative titles of AIFs from an EU member state.

As regards distribution and marketing to retail investors, in addition to the passporting formalities above, it is required that AIFs which are marketed in Romania comply with the Romanian legislation which sets up investment limits, reporting, transparency and marketing obligations applicable to Romanian AIFs which attract financial resources publicly.

Are there any restrictions on managing a fund?

The management of Undertakings for Collective Investments In Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) is a regulated activity subject to authorization by the Financial Supervisory Authority (FSA).

Authorization of both investment management companies and AIF managers (AIFMs) is subject to a significant authorization process which may take up to six months starting from the completion of the application. Authorization requirements mainly refer to initial capital minimum levels, shareholders’ financial soundness, expertise and integrity of management bodies, senior personnel requirements (must be suitable persons with adequate expertise and reputation), business plan and organization structure, policies and procedures.

AIFMs which were previously authorized by the FSA as investment management companies, are not required to refile the documents already submitted upon authorization as an investment management company.

The FSA authorization of an AIFM or an investment management company is valid for all EU member states based on the European passport. They may perform the financial services for which they are authorized by the FSA in another member state either by establishment of a branch or directly, under the direct provision of services.

Following authorization, investment management companies and AIFMs are subject to various regulatory requirements, including in relation to own funds, conflicts of interest, risk management policies and remuneration policies.
Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

In order to trade, as a business, in their name and on their own account, in derivative financial instruments, such as futures contracts and options, a legal person must be authorized by the Financial Supervisory Authority (FSA) and registered with the FSA's Registry.

The European Market Infrastructure Regulation applies to all derivative transactions and requires transactions to be reported to regulators, transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

Last modified 20 Oct 2017

What are common types of derivatives?

Derivative contracts are entered into in Romania for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange. All of the main types of derivative contracts are used in Romania:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying assets seen in Romania are:

- equity;
- indices;
- commodities; and
- foreign currency.

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Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

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Debt finance
Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Professional lending is a regulated activity, which may exclusively be undertaken by regulated entities. Depending on the type of loans being granted, various specific requirements or limitations should be considered.

By way of example, mortgage loans for real estate investments (credite ipotecare pentru investitii imobiliare) can be granted only by certain regulated entities (e.g., universal banks or mortgage loan banks). Moreover, the credit agreement for such type of loans must include certain information expressly required by law. There are also particular requirements on how to deal with borrowers that fall behind with their payments.

Specific rules are also provided under the law on consumer loans.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer-lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

What are common lending structures?

Lending in Romania can be structured in a number of different ways, mainly depending on the complexity and the value of the transaction and, generally, the overall commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders, each providing parts of the overall facility).

Syndicated facilities, by their nature, involve more parties (such as agents and security agents which fulfil certain roles for the finance parties), as well as more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicates taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, e.g., term loans, working capital loans, project loans, acquisition loans, real estate loans or letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can be either secured or unsecured. For more information, see Giving and taking guarantees and security.

Loan commitment
In practice, a loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan (although in this case there may be certain legal issues to be considered).

**What are the differences between lending to institutional / professional or other borrowers?**

In principle, lending to institutional or professional borrowers is more flexible, while lending in the context of mortgages and to consumers is subject to more regulatory oversight and is more cumbersome from a compliance perspective.

For more information, see Lending and borrowing – restrictions.

**Do the laws recognize the principles of agency and trusts?**

The Romanian Civil Code expressly recognizes the possibility to create a movable mortgage in favor of a third party (agent) designated by the secured creditor. Such agent shall exercise all rights of the secured creditor which appointed it. This concept is, however, provided by law only in case of movable mortgages (immovable mortgages are therefore excluded). In practice, however, such an agency mechanism is not that frequently used, due to its limited regulation.

Furthermore, Romanian law does not recognize the common law concepts of ‘trusts’ and ‘trustee’. However, since October 2011, the Romanian Civil Code has introduced a concept similar to a trust, namely the ‘fiducia’. However, given the legal requirements related to the creation and registration of a fiducia (including tax related requirements), the fiducia is not commonly used in practice, particularly for taking security. Thus, in syndicated facilities security agents structures are commonly used.

**Are there any other notable risks or issues around lending?**

Romanian law prohibits a Romanian company from making, directly or indirectly, loans to its directors or officers, or to spouses, certain relatives or in laws of such directors or officers, or to any companies in which such a person is director or manager, or holds 20% or more of the share capital. Transactions may be invalidated for this reason and there may also be criminal sanctions.

Insolvency-related limitations should also be taken into consideration. By way of example, Romanian insolvency law prohibits the acceleration of loans due to reasons related to the opening of insolvency proceedings against the borrower.

As a general note, Romanian law governed loan agreements and other finance documents are subject to general contractual lending principles. Depending on the lending transaction’s size and type, loan agreements used on the Romanian market are usually based on the bank’s standard form documentation (particularly in the case of bilateral loans and small transactions) or Loan Market Association (LMA)-style facility agreements (eg for syndicated loans).

**Are there any other notable risks or issues around borrowing?**

Borrowing by Romanian residents from non-residents for a period exceeding one year is subject to notification to the National Bank of Romania for statistical purposes.
Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Corporate benefit and misuse of corporate assets

Upstream or cross-stream guarantees or security usually raise corporate benefit issues under Romanian law. Each guarantor or security provider must receive a real and adequate corporate benefit from assuming such guarantee obligations. Additionally, the absence of any corporate benefit may be construed as a lack of cause for the guarantee or security, with the risk of the respective guarantee or security agreement being invalidated on these grounds. Corporate benefit is, however, a matter of fact assessed on a case-by-case basis by the courts.

Furthermore, the directors or officers and the (founding) shareholders of a Romanian company are criminally liable if they intentionally misuse the assets (including moneys or loans) of the company for a purpose contrary to the company's interest or in its own interest or in order to favor another company in which such persons have a direct or indirect interest. As a consequence, if there is a misuse of corporate assets, the related transactions may also be invalidated.

Prohibition from securing loans granted to directors

Romanian law prohibits a (joint-stock) company to conduct credit activities to the benefit of its directors through various operations, including through the creation of security aimed at securing, totally or partially, any loans granted to the respective director(s). The same prohibition applies to operations in which the respective directors' spouses, certain relatives or in-laws are interested, as well as in case the security is granted to another company with which it shares one (or more) directors (or the directors which are relatives) or to any companies in which such a person is director or manager, or holds 20% or more of the share capital. Transactions may be invalidated for this reason and there may be also criminal sanctions. There are certain exemptions from this prohibition provided by Law No 31/1990 on companies.

Insolvency

Insolvency proceedings may have various impacts on receivables which are preferred by law and rank above any other receivables (eg privileges, mortgages, pledge over assets of the insolvent debtor) and the creditors which have such type of receivables. By way of example, following the commencement of insolvency proceedings, all court and out-of-court actions or enforcement measures for the settlement of claims over the debtor are suspended by operation of law. Also, security created for a prior, existing, but unsecured receivable, within the six month period prior to the opening of insolvency proceedings may be invalidated. Similarly, fraudulent acts committed by a debtor during the two years preceding the commencement of insolvency proceedings may also be invalidated.

Financial assistance

According to Law No 31/1990 on companies, a (joint-stock) company cannot create any security in favor of another party in order for such other party to acquire that company's own shares. Breach of this rule renders the guarantee null. Such prohibition is not applicable to transactions carried out in the ordinary course of business of credit institutions or any other financial institutions or to transactions carried out with a view to acquiring shares by or for that company's employees, provided that such transactions do not trigger the reduction of the net assets of the company below the aggregated value of the subscribed share capital and the reserves that cannot be distributed according to law or constitutive act.

Corporate approvals

The borrower should ensure that it has in place all necessary corporate approvals taken at the approval level required by its articles of association and other applicable corporate decisions setting forth the competences of its corporate bodies. In practice, these are either a shareholders' resolution or a board decision. In case of a joint-stock company, a shareholders' resolution is mandatory if the facility exceeds 50% of the book value of the assets of the respective joint-stock company.
What are common types of guarantees and security?

Romanian law regulates two main types of guarantees/security: personal guarantees and in rem security.

Personal guarantees

The most common ones are:

- suretyship (*fideiusuie*); and
- autonomous guarantees (which, in their turn, may take the form of:
  - letters of guarantee; and
  - letters of comfort).

In rem security

The most commonly available in rem security are (conventional) mortgages, which do not entail the dispossession of the security provider. Depending on the type of assets taken as security, mortgages can be either:

- **movable mortgages** – covering various tangible or intangible, present and future movable assets (by way of example, a movable mortgage may be created over bank accounts, shares, receivables, intellectual property rights, insurance policies rights, machinery, inventory, universalities of movable assets which are assigned to the activity of an enterprise etc); or

- **immovable mortgages** – covering immovable assets together with their accessories, superficies rights etc (the Romanian Civil Code expressly recognizes the possibility to create an immovable mortgage over future buildings).

Romanian law also regulates privileges, which are claims preferred by law and which have in principle the highest rank. Privileges can be either general (over all movable and immovable assets of the debtor) or special (eg the privilege of the seller’s claim for the unpaid price of a movable asset sold to a natural person, save for the case when the buyer acquires the asset for the service or exploitation of an enterprise). There are special priority rules provided by the law with respect to privileges and mortgages.

Furthermore, quasi-security may also be used in practice, such as assignment of receivables for security purposes (*cesiune de creanta in scop de garantie*), retention of title (*clauzele de rezerva a proprietatii*). They are subject to the same priority and enforcement rules as those provided by law for mortgages.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking personal guarantees

Suretyship is fairly common in lending transactions in Romania. It is an agreement whereby the guarantor undertakes to the creditor to fulfil the obligations of the debtor (either on a free-of-charge basis or against a consideration) in case the latter fails to comply with such obligations. The suretyship cannot be presumed, it must be specifically undertaken by way of a written agreement concluded either as an authentic deed (in front of a notary public) or as a private deed or, in certain cases, even included in the facility agreements. There are specific legal conditions that need to be observed by the guarantor (eg to have and maintain sufficient assets in Romania to cover the secured liabilities, to be domiciled in Romania), however, these rules do not apply in case a certain provider of the suretyship was specifically requested by the creditor.

There are no registration formalities provided by the law for suretyships.

Giving or taking in rem security

Immovable mortgages are subject to certain formal requirements which render them valid and enforceable against third parties. Specifically, immovable mortgages can only be created through an agreement authenticated by a notary public, subject to payment of
notarial fees. Immovable mortgages must be registered with the land book where the mortgaged real estate is registered, subject to payment of registration fees.

As concerns movable mortgages, they are validly created through movable mortgage agreements concluded either as private deeds or as authenticated deeds. The ranking of a movable mortgage is generally given by the registration with the so-called Electronic Archive for Movable Security (Arhiva Electronica de Garantii Reale Mobiliare). Such registration is valid for a five-year period and may be renewed before its expiry. Depending on the specific type of mortgaged assets, other registration formalities may apply (eg registration with the shareholders' registry in case of mortgages over shares, the creation of 'control' over the mortgaged bank accounts etc).

As a general requirement, a mortgage agreement (either movable or immovable) is not valid unless the amount for which the mortgage is created can reasonably be determined on the basis of the mortgage agreement. Also, under the sanction of nullity, the mortgage agreement must include a sufficiently precise description of the mortgaged asset, reasonably allowing its identification. The mortgaged assets may be described by drafting a list of the mortgaged movable assets, by determining the category to which they belong, by indicating their quantity, by providing a formula for their determination or by any other method which reasonably allows their identification. In the particular case of mortgages over bank accounts, for validity purposes the respective bank accounts must be expressly set out under the movable mortgage agreement.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Credit institutions

Government Emergency Ordinance No 99/2006 on credit institutions and capital adequacy (Ordonanta de urgenta nr. 99/2006 privind institutiile de credit si adecvarea capitalului) (taking up and pursuit of the business of credit institutions)

National Bank of Romania (NBR) Regulation No 5/2013 on prudential requirements for credit institutions (Regulamentul nr. 5/2013 privind cerinte prudentiale pentru institutiile de credit) (prudential requirements for credit institutions)

Law No 312/2015 regarding the recovery and resolution of credit institutions and investment firms, as well as for amending and completing certain regulations in the financial field (Legea nr. 32/2015 privind redresarea si rezolutia institutiilor de credit si a firmelor de investitii, precum si pentru modificarea si completarea unor acte normative in domeniul financiar) (recovery and resolution of credit institutions and investment firms)

NBR Regulation No 4/2014 on reporting statistic data and information to the National Bank of Romania (Regulamentul nr. 4/2014 privind raportarea de date si informatii statistice la Banca Nationala a Romaniei) (reporting for statistic purpose of financial data and information to the National Bank of Romania by credit institutions, non-banking financial institutions, investment firms or other reporting entities)

NBR Regulation No 4/2005 on the foreign exchange regime (Regulamentul nr. 4/2005 privind regulul valutar) (foreign exchange regime)

Non-banking financial institutions

Law No 93/2009 regarding non-banking financial institutions (Legea nr. 93/2009 privind institutiile financiare nebancare) (taking up and pursuit of the business of non-banking financial institutions)

Regulation No 20/2009 regarding non-banking financial institutions (Regulament nr. 20/2009 privind institutiile financiare nebancare) (registration, communication of changes occurred in the status of non-banking financial institutions and prudential requirements applicable to non-banking financial institutions)

Consumer credit
Government Emergency Ordinance No 52/2016 on credit agreements for consumers relating to immovable property, as well as for amending and supplementing the Government Emergency Ordinance No 50/2010 on credit agreements for consumers (Ordonanta de urgența nr. 52/2016 privind contractele de credit oferite consumatorilor pentru bunuri imobile, precum și pentru modificarea și completarea Ordonantei de urgența a Guvernului nr. 50/2010 privind contractele de credit pentru consumatori) (credit agreements for consumers relating to immovable property, prudential and supervisory requirements (including for the establishment and supervision of credit intermediaries and debt recovery entities), aspects regarding the provision of ancillary services)

Government Emergency Ordinance No 50/2010 on credit agreements for consumers (Ordonanta de urgența a Guvernului nr. 50/2010 privind contractele de credit pentru consumatori) (credit agreements for consumers)

Government Ordinance No 21/1992 on consumer protection (Ordonanta nr. 21/1992 privind protectia consumatorilor) (consumer protection)

**Mortgages**

Law No 287/2009 regarding the Civil Code (Legea nr. 287/2009 privind Codul Civil) (Civil Code of Romania)

Law No 77/2016 on giving in payment of real estate assets for discharging loan debts (Legea nr. 77/2016 privind darea in plata a unor bunuri imobile in vederea stingerii obligatiilor asumate prin credite) (giving in payment of real estate assets for discharging loan debts – datio in solutum)

Law No 190/1999 regarding mortgage loans for real estate investments (Legea nr. 190/1999 privind creditul ipotecar pentru investitii imobiliare) (mortgage credits for real estate investments)

**Corporations**

Companies Law No 31/1990 (Legea societatilor comerciale) (legal regime of companies)

**Funds and platforms**

Law No 297/2004 on the capital market (Legea nr. 297/2004 privind piaa de capital) (capital market)

Law No 74/2015 on alternative investment fund managers (Legea nr. 74/2015 privind administratorii de fonduri de investitii alternative) (alternative investment fund managers)

Government Emergency Ordinance No 32/2012 on undertakings for collective investment in transferable securities and investment management companies and for amending and supplementing Law No 297/2004 on the capital market (Ordonanta de urgența nr. 32/2012 privind organismele de plasament colectiv în valori mobiliare i societatele de administrare a investitiilor, precum și pentru modificarea i completarea Legii nr. 297/2004 privind piaa de capital) (undertakings for collective investment in transferable securities and investment management companies)

Financial Supervisory Authority (FSA) Regulation No 9/2014 on the authorization and operation of investment management companies, undertakings for collective investment in transferable securities and depositaries of undertakings for collective investment in transferable securities (Regulamentul ASF nr. 9/2014 privind autorizarea i funcionarea societilor de administrare a investitiilor, a organismelor de plasament colectiv în valori mobiliare i a depozitarilor organismelor de plasament colectiv în valori mobiliare) (authorization and operation of investment management companies, undertakings for collective investment in transferable securities and of the depositaries of undertakings for collective investment in transferable securities)

National Securities Commission (NSC) Regulation No 15/2004 on the licensing and functioning of investment management firms, collective investment undertakings and depositaries (Regulamentul CNVM nr. 15/2004 privind autorizarea i funcionarea societilor de administrare a investitiilor, a organismelor de plasament colectiv i a depozitarilor) (licensing and functioning of investment management firms, collective investment undertakings and depositaries)

FSA Regulation No 10/2015 on alternative investment funds management (Regulamentul ASF nr. 10/2015 privind administrarea fondurilor de investitii alternative) (alternative investment funds management)

**Other key market legislation**

Government Ordinance No 9/2004 on financial collateral agreements (Ordonanta nr. 9/2004 privind unele contracte de garanie financiar)
Regulatory authorization

Who are the regulators?

The main regulator in the banking sector is the National Bank of Romania (NBR) which is the Romanian central bank. The NBR has, inter alia, authorization, prudential supervising and regulatory competences in relation to credit institutions.

The Financial Supervisory Authority (FSA) is the regulatory and supervisory body responsible for capital markets. The FSA's role includes authorizing investment firms, management companies and investment funds, providing the general listing requirements for issuers, regulating the securities exchange and enforcing the market abuse regulations.

What are the authorization requirements and process?

Depending on its type, an entity must apply to the National Bank of Romania (NBR) or the Financial Supervisory Authority (FSA) for authorization.

Credit institutions and non-banking financial institutions

Romanian credit institutions (as well as the branches of credit institutions from third (non-EU/ European Economic Area) states must be authorized by the NBR when performing a regulated activity in Romania. The authorization process comprises two stages, namely the:

- approval of the establishment of the respective credit institution; and
- authorization of the functioning of such credit institution.

The NBR will also approve key individuals (eg senior management) in their roles at the level of the respective credit institution.

The NBR must approve or reject a request for authorization within four months of the application. Such term may be suspended in certain cases provided by law. Authorized credit institutions are registered with a special register maintained by the NBR.

Also, Romanian non-banking financial institutions (NFIs) (as well as subsidiaries established in Romania by foreign NFIs) may perform lending activities in Romania only after registration with the NFI General Registry or, as applicable, the NBR Special Registry, maintained by the NBR. Such registration is performed by the NBR upon notification of the establishment of the respective NFI (which must be performed within 30 days of the NFI registration with the Romanian Trade Register) and submission of the required documentation.

Investment firms and investment vehicles

Both investment firms and investment vehicles must apply to the FSA for authorization.

In order to be licensed by the FSA, investment firms must satisfy the required conditions including:
• the initial capital must amount to at least the RON equivalent of €730,000; and
• the day-to-day management must be carried out by at least two persons, who are also empowered to represent the investment firm.

What are the main ongoing compliance requirements?

Threshold conditions (such as having adequate own funds and compliance arrangements in place) are an ongoing compliance requirement for credit institutions, non-banking financial institutions, investment firms, investment vehicles and fund managers.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for regulated entities, such as written warning, fines, temporary suspension of the respective entity’s authorization or even prohibition from performing the authorized activity.

What are the penalties for failure to be authorized?

A person undertaking a regulated activity consisting of lending activities, investment services or other activities specific to credit institutions, investment firms and/or investment vehicles, without being authorized, commits a criminal offence and may be liable to imprisonment.

Regulated activities

What finance and investment activities require authorization?

As a general rule, the performance without authorization of any activities or operations for which the laws regulating the financial sector require authorization is prohibited and, in most cases, gives rise to criminal liability.

Under Romanian law, it is generally prohibited for any individual or legal entity (other than a credit institution) to pursue activities such as attracting deposits or other repayable funds from the public.

Furthermore, professional lending is a regulated activity, which may exclusively be undertaken by regulated entities, such as credit institutions, non-banking financial institutions or payment services providers which perform lending activities in relation to payment services.

Offering investment services and managing investment vehicles are also comprehensively regulated activities, and require authorization by the Financial Supervisory Authority.

Are there any possible exemptions?

Individuals or legal entities that are not credit institutions are not permitted to carry on activities such as taking deposits or other repayable funds from the public. This prohibition is not applicable to taking of deposits or other funds repayable by a member state of the EU, or by a member state’s regional or local authorities, or by public international bodies provided that one or more member states are members to the public international body. The prohibition also does not apply to cases expressly covered by national or EU legislation, provided that those activities are subject to regulations and controls intended to protect depositors and investors, and applicable to those cases.

To the extent that lending activities are performed incidentally and not on a professional basis, they may be freely undertaken by any individual or entity (not necessarily by regulated entities). The National Bank of Romania has a monopoly in determining, on a case-by-case basis, whether a determined activity constitutes professional lending, by applying the criteria provided by Law No 93/2009 regarding
Do any exchange controls or other restrictions on payments apply?

There are certain general foreign exchange rules provided by Romanian law. By way of example, making or receiving payments, transfers and any other similar operations arising out of the sale of assets, or the provision of services between Romanian residents must be made only in Romanian currency (i.e. RON), except for certain specific operations, as provided by law, which may also be performed in other currencies. Operations between residents and non-residents can be performed either in Romanian currency or in a foreign currency.

In addition, there are certain threshold limitations for monetary transactions provided under the anti-money laundering law which may trigger various reporting obligations (e.g., for cash transactions involving amounts of at least the RON equivalent of €15,000, or for external transfers made in or from accounts and amounting to at least the RON equivalent of €15,000).

Statutory blacklists operate to prohibit, or restrict funds being sent to, or received from, persons in certain countries.

Also, certain reporting requirements apply to loans received by Romanian residents from non-residents.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must also be ensured.

Furthermore, there are specific rules provided by the law for cash transactions between legal entities and other persons.

What are the rules around financial promotions?

There are various legal requirements applying to financial promotions and marketing.

For example:

- Any advertising concerning credit agreements for consumers must include certain standard information and be presented in a certain way.
- There are specific rules on credit agreements for consumers relating to residential immovable property.
- Long distance contracts regarding financial services (e.g., banking services, credit-related services, financial investments services, etc.) are subject to various rules regarding the information to be provided to consumers who are entering into such contracts.

There are also specific rules around marketing materials for Undertakings for Collective Investments In Transferable Securities (UCITS).

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities in the financial sector are joint-stock companies and limited liability companies. They are subject to relatively straightforward rules and their shareholders benefit, in general, from limited liability (up to the amount of the subscribed capital). Unlike limited liability companies, joint-stock companies may be listed on regulated markets and have a more complex organization.

Certain financial activities can only be performed by entities set up in a particular type of legal entity (e.g., credit institutions and NFIs can only take the form of a joint-stock company).

Investment firms and investment vehicles
Investment firms are set up in Romania as joint-stock companies whose object of activity is to perform investment services.

Open-ended investment funds are created on the basis of a simple partnership contract, they have no legal personality and are managed by an investment management company, which must be incorporated as a joint-stock company.

Open-ended investment companies are set up as joint-stock companies and may be managed either by their board of directors or by a separate investment management company.

Closed-ended investment funds are established on the basis of a simple partnership contract and are managed by an investment management company.

Closed-ended investment companies are established as joint-stock companies. The management of the closed-ended investment company is ensured either by its own board of directors or by a separate investment management company.

Financial investment companies are a special type of closed-ended investment companies. They are joint-stock companies the shares of which are then traded on the Bucharest Stock Exchange and are subject to the same rules as the closed-ended investment companies.

**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes.

Lending and/or financial investment services may be performed in Romania on a professional basis by, *inter alios*:

- credit institutions (or payment services providers) and investment firms, respectively, which are licensed in an European Economic Area member state to perform lending/financial investment services and which carry out such services in Romania either:
  - directly (under the freedom to provide services); or
  - by way of establishment of a Romanian branch (under the freedom of establishment) based on a (banking) license obtained in their home member state, without the need to obtain a (banking) license in Romania (they are, however, subject to performing certain administrative formalities (the so called ‘passporting’ formalities)); and
- Romanian branches of non-European Economic Area member states licensed (credit) institutions (to the extent the Romanian branches were licensed in Romania by the National Bank of Romania or the Financial Supervisory Authority, respectively).

**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Peer to peer funding platforms and marketplace lending**

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through an electronic bank lending platform established as a specialist corporate or special purpose vehicle based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
In Romania, peer-to-peer (P2P) funding platforms are not popular. However, there is one intermediary platform which operates as an internet-based intermediary between natural persons who can offer and request loans; a couple of similar platforms are being developed and we anticipate evolution in the field (alongside the currently more popular crowdfunding platforms).

**Blockchain, smart contracts and cryptocurrencies**

The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

While the use of both of bitcoin and blockchain technology is expected to become mainstream, Romania has yet to embrace this global trend. According to data released in March by Netopia mobilPay, Romanians made payments in bitcoin equivalent to €300,000 in 2016. The average payment value per was €400.

Currently, there are no specific regulations concerning bitcoin in Romania. The National Bank of Romania has taken a reserved attitude towards blockchain technology and bitcoin; reflecting the perspective of the European Central Bank. In March 2015, the National Bank of Romania issued a statement in relation to cryptocurrencies confirming that they are considered neither national, nor foreign currency and may not be considered e-currency either, which leads to an argument that bitcoin falls under the category of movable goods and, as a result, any transaction which applies a bitcoin ‘payment’ may qualify as barter trading, in accordance with article 1763 of the Romanian Civil Code.

**Initial coin offerings and token based products**

Issuing digital tokens by way of an initial coin offering (ICO) is not common practice in Romania. However, there are startup projects, including in the video gaming market sector, which have raised financing by means of an ICO. Issuance of tokens to fundraise in the video gaming market (where such tokens may be used for purchases within the game as well as being exchangeable in other cryptocurrency markets) is expected to grow and may be copied by issuance of so-called utility (discount) tokens in other market sectors.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Based on a recent study in Romania, 60% of the financial intermediaries interviewed mentioned that the main reason for using AI interfaces was data collection. On the other hand, the study also highlighted that concerns about the privacy of data are one of the main challenges to further development, as well as a preference for human interactions. The survey also found that although the number of human interactions at banks or telephone offices is decreasing and is likely to continue in line with this trend, the quality and importance of human contact will increase.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Cloud computing is most commonly used in the financial sector for the following services:

- internet banking platforms; and
- outsourcing activities with respect to services previously carried out by the financial institution (eg electronic archiving, e-mailing services etc).
Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

As a general rule, performing any activities or operations for which the laws regulating the financial sector require authorization, is prohibited without the appropriate authorization and, in most cases, doing so gives rise to criminal liability.

Under Romanian law, it is generally prohibited for any individual or legal entity (other than an appropriately licensed credit institution) to pursue activities such as deposit-taking (or holding other repayable funds from the public). Furthermore, professional lending is a regulated activity, which may only be undertaken by regulated entities, such as licensed credit institutions, non-banking financial institutions or payment services providers that perform lending activities in relation to payment services.

Payment services can only be performed either by an authorized payment institution (together with credit institutions, e-money institutions) or authorized agents of one of the above.

Money remittance services are similarly regulated and all such credit institutions, payments services institutions and e-money institutions must be authorized by and registered with the National Bank of Romania.

The offering of investment services and managing investment vehicles are also comprehensively regulated activities, and require authorization by the regulator.

Electronic payments platforms and regulation of peer to peer lenders

Electronic payment platforms

A number of FinTech businesses are offering electronic payment platforms to rival the traditional payment systems. These are mostly payment services institutions authorized in another European Union member state which provide payment services in Romania by passporting their home license (either directly or via local branches).

Peer to peer lenders

Peer-to-peer (P2P) lending is not yet regulated in Romania. The local market remains undeveloped, however, lending via crowdfunding platforms has begun to develop in recent years and draft legislation has been produced but is not yet implemented. It is expected that P2P lending platforms will grow alongside this sector.

Regulation of payment services

Where an entity provides payment services on a professional basis in Romania, it will require authorization by the National Bank of Romania to become an authorized payment institution under the Payment Services Ordinance No 113/2009 implementing the European Union Payment Services Directive I. Failure to obtain the required authorization is a criminal offence. Furthermore, payment services may also be performed by authorized credit institutions as well as by other authorized institutions, such as credit institutions or e-money institutions.

In order to become authorized by the National Bank of Romania, a payment services business will need to meet certain criteria, including in relation to its business plan, regulatory capital, requirements, processes and procedures in place for safeguarding relevant funds and money laundering controls.

Application of data protection and consumer laws

Law No. 677/2001 'on the Protection of Individuals with Regard to the Processing of Personal Data and the Free Movement of Such Data' (Law 677/2001) regulates the processing of personal data in Romania. Law 677/2001 implements the European Data Protection Directive. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by Law 677/2001 and have certain notification and compliance obligations.
In addition, the European General Data Protection Regulation (GDPR) will replace the existing law with effect from 25 May 2018. The GDPR is more prescriptive and restrictive and includes mandatory notification requirements where a breach occurs, together with severe monetary sanctions for breach.

**Money laundering regulations**

Law No 656/2002 'on the Prevention and Sanctioning of Money Laundering and Countering the Financing of Terrorism' gives the National Bank of Romania responsibility for supervising the anti-money laundering obligations of entities that offer certain services, such as lending, providing payment services and issuing and administering other means of payment.

Generally, where a legal entity is supervised by the National Bank of Romania, it will also be supervised by the same authority for compliance with anti-money laundering requirements. The same is provided in the draft law for the implementation of the European Union’s Fourth Money Laundering Directive, not yet implemented in Romania.

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**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

Crowdfunding may be appropriate for a FinTech business in the early stages. This involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdcube or Crowdfunder.

There are two main types of crowdfunding: equity and reward-based.

- Equity-based crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

Lending via crowdfunding platforms has begun to develop in recent years, but the local market remains immature. Most of the platform providers are organized as foundations and the fundraisers are usually non-profit organizations or natural persons. Generally, they are structured to function on the basis of donations received by the fundraiser and rewards (in the form of services or products) provided at a later date to the donors. The types of projects which have successfully raised the proposed financing are usually arts and technology orientated.

A legislative initiative for the enactment of a law on crowdfunding was launched during 2015. The draft has been approved by the Romanian parliament first chamber and it is currently under discussion in front of the second chamber (the Deputies House). Once implemented, the draft law will regulate both equity-based crowdfunding as well as credit-based crowdfunding. Donation-based crowdfunding structures are expressly excluded from the scope of the draft law and it is expected that these types of platforms will continue to function as they currently do. Reward-based crowdfunding is not mentioned expressly.

**ACCELERATORS**

There are various tech events or accelerators in the Romanian market which offer support, facilities and funding for startups, often in return for an equity stake. In 2016 there were almost 200 startups financed in this way in Romania. These ‘angel advisors’ help startups
not only with funding but also with mentoring and guidance.

Venture capital

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

VC funding is being used more frequently by FinTech companies in the first years of their existence, with 20 startups in Romania raising €11.3 million in total in 2016. For example, Vector Watch (owned by Romanian entrepreneurs and recently acquired by the global wearable giant Fitbit) raised €5 million in 2015. Also, a Romanian robotic form-scanning software company, UiPath has raised $30 million in venture funding, marking one of the largest early-stage tech investments in Central Europe.

Warehouse and platform funding

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead interest is paid on the money borrowed. In the Romanian market, some foreign P2P lending platforms are used by both Romanian investors and borrowers and a leading non-bank mortgage loan originator in Romania (Extra Finance) recently joined the Mintos marketplace. Domestic P2P lending platforms are also being developed.

Senior bank debt and capital markets funding

Senior Bank Debt

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding, which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

Capital Markets Funding

While more common in other jurisdictions, FinTech fundraising by way of an Initial Public Offering or loan securitization have not, to our knowledge, been used as yet in Romania.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Romanian law provides for various legal mechanisms for transferring rights and obligations, including those under loan agreements. The most common methods for transferring loans are as follows.

Assignment of receivables

The assignment occurs by the mere convention between the owner of certain receivables (assignor) and the buyer of those receivables (assignee), following which the assignee acquires:

- the receivables and all rights held by the assignor in relation to the assigned receivables, as well as
- all (assignable) security/guarantees and other rights accessory to the assigned receivables.

In principle, the consent of the assigned debtor is not required, except for cases when, depending on circumstances, the respective receivables are 'essentially linked to the creditor (assignor)', ie it can be enforced by the creditor only. The enforceability of the assignment
of receivables against third parties, including the assigned debtor is achieved upon fulfilment of certain formalities, such as:

- written notice of the assignment to the assigned debtor(s), or written acknowledgement of the assignment signed by the assigned debtors, bearing a certain date; and
- registration of the assignment with the Romanian Electronic Archive for Movable Security (Arhiva Electronica de Garantii Reale Mobiliare).

**Assignment of contract**

This is a mechanism introduced by the Romanian Civil Code (in force as of 1 October 2011). It allows a party to a contract to be replaced by a third party in that contract provided that the initial contractual parties have not yet fulfilled all their obligations under the respective contract and the counterparty agrees to such replacement. The assignment agreement and the acceptance of the assignment by the counterparty must be concluded in the form prescribed by law for the validity of the assigned contract.

**Novation**

The novation option implies the extinguishment of the existing contractual relationship and the creation of a new one. The novation may be achieved in three different ways, namely:

- The debtor undertakes a new obligation towards the creditor, which replaces and extinguishes the initial obligation.
- A new debtor replaces the initial debtor, the latter being released from its obligations towards the creditor.
- A new creditor replaces the initial one, the debtor being released from its obligations towards the initial creditor.

As a general principle, the security or guarantees securing the initial receivable are not maintained unless expressly agreed by the parties.

**Subrogation**

This mechanism operates when a third party pays instead of the debtor (e.g. borrower) and is subrogated to the creditor's rights against the debtor.

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**What are the main considerations when transferring a loan and related security?**

Recent legislative developments brought some changes to the legal regime applied to the transfer of loans, including on the consumer-lending side. Before 30 September 2016, the rule provided by law was that portfolios of loans originated by financial institutions could be acquired only by regulated entities (e.g. credit institutions, non-banking financial institutions and payment services providers granting loans related to the payment services). However, such rule did not apply if the loans were deemed as 'losses' within the meaning of Romanian regulations regarding credit classification.

After 30 September 2016, such legal provisions were expressly repealed and we are currently lacking an express legal provision dealing with acquisition of loans in general. However, the National Bank of Romania has recently issued a communication stating that, to the extent the activity to be performed by the acquirer of loans in relation to the acquired loans represents crediting activities performed on a professional basis, the acquirer must be a regulated entity. Further, the National Bank of Romania concluded that the acquisition of loans granted to individuals and legal entities, which are deemed as 'losses' within the meaning of Romanian regulations regarding credit classification, does not represent a crediting activity performed on a professional basis and, therefore, can also be performed by other persons than regulated entities.

Further, specific rules regarding the acquisition of consumer loans (including non-performing loans) are provided by law.

In addition, various other issues may need to be considered in the context of transferring a loan or a portfolio of loans, the potential limitations being usually revealed in the course of the due diligence process conducted in such loans acquisition deals. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a
potential purchaser or whether additional measures might need to be implemented in order to ensure compliance with data privacy limitations;

- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee;

- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms;

- **consent** – whether a transfer requires the consent or notification of any other parties; and

- **formalities in relation to the security** – in case of secured loans, additional formalities regarding security interests and personal guarantees securing the transferred loan(s), may be applicable depending on the relevant security package (in general, the new secured creditor must be registered with the relevant public registers – eg the Land Book in case of immovable mortgages, or the Electronic Archive for Movable Security in case of movable mortgages – for opposability purposes).

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**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Romania varies as follows:

**Oil and gas**

The oil and gas industry is privatized especially in the sectors of oil and gas downstream and upstream. Most of the assets in the oil industry are privately owned, except those which are included in the public domain such as: underground resources, energy transmission assets, oil and gas pipelines, water storages and dikes.

The gas midstream is owned by the Romanian state through the national company Transgaz.

**Electricity**

Most of the companies involved in the generation, transmission and distribution of electricity are state owned (as either majority or full owner) and some of them are listed on the Bucharest Stock Exchange. However, the regional electricity companies which supply electricity to the off takers are privatized.

ANRE (National Authority for Regulation in the Energy Field) is the regulatory and supervision authority in the electrical energy and gas field and OPCOM is the administrator of the electrical energy market.

**Telecoms infrastructure**

The telecommunications networks (fixed and mobile) in Romania are mostly privately owned by a number of international and local service providers. Certain assets – such as frequency spectrums and the telecommunication transportation and distribution networks – are in the public domain.

ANCOM (National Authority for Administration and Regulation in Communication) is the administration authority of the communication market.

**Transport infrastructure**

LIGHT RAIL
Typically, light rail assets (such as trams) are owned by local public sector. The Bucharest underground infrastructure, network and trains are owned by the Romanian state through the Ministry of Transport.

HEAVY RAIL

The rail network and infrastructure in Romania is owned by the Romanian state. There are only few small companies which operate trains on some rail routes, especially commercial trains.

The rail sector is regulated by the Office of Rail and Road (ORR).

AVIATION

While the operators are both publicly or private owned, the airports infrastructure is owned by the Romanian state.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector with the exception of few hospitals and schools which are in the private sector.

DEFENSE

Defense assets are owned by the public sector.

WASTE

While in few municipalities facilities such as landfills, collection and transportation of the waste are in the private sector, the local public entities are still operating such facilities in most of the cities.

Are there special rules for investing in energy and infrastructure?

In Romania there are no specific regulations permitting or restricting investments in energy or infrastructure. Depending on the type of investment and the area in which such is envisaged to be made, various legal provisions may be applicable throughout the various stages of the investment, for example:

- corporate and civil law provisions applicable with respect to the setting-up of the investment vehicle, acquisition/sale of control in the investment vehicle, joint ventures etc;
- public procurement regulations in case of investments undertaken by public authorities or certain types of companies (such as energy-producing companies), which regulate aspects such as initiation of the investment, procurement of works, products and services related to the investment etc;
- legislation regarding European funds or state aid schemes, to the extent these are used for the funding of the investment; and
- general regulatory provisions related to design, construction, commissioning and operation of an investment project, including construction provisions, environmental provisions etc.

Special regulatory provisions are applicable for each category of project in energy (e.g. electricity, nuclear and thermal energy production investment projects) or infrastructure (telecommunications, railway and road infrastructure investment projects).

What is the applicable procurement process?

Public procurement in Romania is, for the time being, regulated by several laws enacted in 2016 aimed to transpose into Romanian legislation the EU public procurement reform, as follows:

- Law on Public Procurement transposing Directive 2014/24/EU on public procurement;
• Law on Sectorial Acquisitions, transposing Directive 2014/25/EU on procurement by entities operating in the water, energy, transport and postal services sectors;

• Law on Concessions of Works and Concessions of Services, transposing Directive 2014/23/EU on the award of concession contracts; and

• Law on Remedies and Appeals Related to Awarding of Public Procurement Contracts, Sectorial Contracts and Works Concession Contracts and Services Concession Contracts, as well as regarding the organization and functioning of the National Council for Solving Complaints, transposing Directive 89/665/EEC on application of review procedures to the award of public supply and public works contracts and Directive 92/13/EEC on application of Community rules on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors.

The key principles are that contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally. They also set out the principle of proportionality and assumption of responsibility.

The award of the contract is determined on a more complex basis, with the sole awarding criterion being the ‘most economically advantageous tender’, which is determined by reference to price or cost, price-quality and/or cost-quality ratio.

Public procurement is relevant where the central authorities, public institutions, local public authorities, local public institutions or State-owned companies, are seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset.

The thresholds triggering application of public procurement rules are as follows:

• RON 23,227,215 (approximately €5.186 million) for public works contracts;

• RON 600,129 (approximately €134,000) for public service contracts; and

• RON 3,334,050 (approximately €750,000) for public service contracts for social and other specific services.

A contracting authority is entitled to purchase directly products or services with an estimated value (excluding VAT) of RON 132,519 (approximately €33,129), or works with an estimated value (excluding VAT) of RON 441,730 (approximately €110,432).

The existing procurement methods are: open tender procedure, restricted tender procedure, competitive dialogue, negotiated procedure without prior publication, design contest, simplified procedure, competitive procedure with negotiation, innovation partnership, awarding procedure for social services and other specific services.

Prior to launching a procurement procedure, contracting authorities may conduct market consultations for preparing the procurement and in this context they may involve independent experts, public authorities or commercial entities, including representative organizations thereof. The advice received may be used in the planning and conduct of the procurement procedure, provided that it does not distort competition and/or results in violation of the principles of non-discrimination and transparency.

To simplify the procedure, the contracting authorities shall accept the European Single Procurement Document (ESPD), consisting of an updated sworn statement of the tenderer/candidate, as preliminary evidence in replacement of certificates issued by public authorities or third parties confirming that the relevant economic operator fulfills the qualification conditions such as not being in the exclusion situations provided by law, meeting the capacity criteria and, as the case may be, meeting the selection criteria. Nevertheless, the contracting authority may ask tenderers/candidates at any moment during the procedure to submit all or part of the supporting documents where this is necessary to ensure the proper conduct of the procedure. The tenderers/candidates are not obliged to provide such supporting documents if the authority has the possibility to obtain them directly by accessing a free national database.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Romania (including in relation to public-private partnerships) are:

Funding
Common forms of funding in energy and infrastructure include:

- loans made on a corporate-finance basis (balance sheet debt); and
- loans made on a project-finance basis.

Funding/funding products can also, sometimes, be provided by the European Bank for Reconstruction and Development.

**Investing**

Common form of investing in energy and infrastructure is 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans.

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**Restructuring**

**Enforcement and sanctions**

**When can there be regulatory investigations?**

The National Bank of Romania, in exercising its supervisory competences, is entitled by law to control and to check, on the basis of various reporting it receives and by investigations at the premises of the controlled entities, the accounts and any documents of the regulated entities that it authorized. Breaches of the applicable regulations may result in various measures and sanctions being applied by the National Bank of Romania, in accordance with the law.

As part of its supervisory competences, the Financial Supervisory Authority is entitled by law to perform on site verifications and, if the case, to order measures and impose sanctions.

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**What regulatory penalties may apply?**

Depending on the breach, the National Bank of Romania may apply various sanctions, varying from written warning, public warning (in which the relevant guilty individual or entity, as well as the breach that has taken place are identified), fines applied to a legal entity (up to 10% of the aggregate net value of the turnover in the preceding financial year), fines applied to individuals (up to the RON equivalent of €5 million). Furthermore, the National Bank of Romania may also impose various measures aimed specifically at ending the observed breaches, such as withdrawal of the authorization granted to the credit institution. The National Bank of Romania makes public on its official website, the sanctions applied, in accordance with the law.

When a rule breach has taken place, the Financial Supervisory Authority (FSA) may issue a warning, impose a financial penalty, suspend or withdraw the authorization against the firm and/or regulated individuals. The FSA will publicize these penalties.

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**What criminal penalties may apply?**

The breach of various legal provisions in the banking and financial investment services fields (such as performing credit activities or financial intermediation on a professional basis without being authorized) may constitute criminal offences punished with imprisonment or otherwise in accordance with the Romanian Criminal Code. The competent courts of law are involved in the actual application of the criminal sanctions.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

In principle, no stamp, registration or similar charges are payable on the granting or registration of security, other than, *inter alia*:

- fees payable for the authentication by a notary public of an immovable property mortgage agreement (such fees are calculated by applying a certain percentage to the value of the secured amount and, therefore, can be significant);
- fees payable to the Electronic Archive of Movable Security (*Arhiva Electronica de Garantii Reale Mobiliare*) or any other relevant public registers for the registration of mortgage agreements; and
- fees payable for the registration of an immovable property mortgage agreement with the relevant land registry.

Depending on the nature of the assets over which security is taken, other forms of registration may also be required (or be advisable), which may also require the payment of fees. Similarly, various registration fees may be payable in the context of the transfer of registered security interests (made with a view to reflecting the change in secured creditor).

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security (eg a bond).

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

As a general rule, tax authorities take priority over other types of creditors in the case of enforcement of security interests. However, in situations where loans are secured over real estate properties or other assets and certain notification procedures have been complied with, secured creditors may take priority over the tax authorities on enforcement.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

As a general rule, interest paid by a Romanian resident to a beneficiary who is not a Romanian resident, is subject to withholding tax.

If so:
What is the rate of withholding?
The current rate of Romanian withholding tax is 16%.

**What are the key exemptions?**

There are specific exemptions from the application of withholding tax for the following types of interest payments:

- interest related to public debt instruments, in Romanian and foreign currency, as well as interest related to instruments issued by the National Bank of Romania for the purpose of achieving the objectives of monetary policies and revenues derived from trading of titles issued by the National Bank of Romania;

- interest related to instruments/titles issued by certain Romanian companies, if such instruments/titles are issued based on a prospectus approved by the relevant regulatory authority and the interest is paid to a person that is not an affiliated person of the issuer;

- interest paid to a related party resident in a member state of the EU, provided that the conditions of the EU Interest and Royalty Directive, as implemented in Romanian domestic legislation, are met; and

- interest paid to certain pension funds, provided that between Romania and the country of residence of the income beneficiaries there is a legal instrument based on which information exchange can be performed.

A reduction or elimination of applicable withholding tax may also be available under the provisions of a double tax treaty concluded between Romania and the country of residence of the recipient/beneficiary, provided that certain requirements are met.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes, both withholding taxes and the applicable exemptions (if the debt security can be classified within the exemptions) are applicable.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

**Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes.

**Key contacts**

**Ioan Chiper**  
Counsel  
DLA Piper Dinu SCA  
ioan.chiper@dlapiper.com  
T: +40372155875
Russia

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on issuing debt securities in Russia which differ for Russian and foreign securities.

For Russian debt securities issued by Russian issuers, the general regulation for securities offerings must apply with special requirements established for each type of debt securities (bonds, depository receipts and etc.).

Foreign financial instruments may only be placed (sold for the first time to the first holder) in Russia if the following conditions are met:

- an international securities identification number (ICIN) and a Classification of Financial Instruments (CFI) are assigned to the instrument; and
- the instrument is qualified as security in accordance with the procedure established by the CBR,

provided that in each case the financial instrument is issued by a foreign issuer that complies with the requirements stated in the law (such as foreign organizations established in states that are members of the Organization for Economic Cooperation and Development (OECD), foreign organizations established in states whose relevant regulators (other authorized institutions) have entered into cooperation agreements with the CBR, and foreign organizations whose securities are listed on foreign exchanges included in the special list approved by the CBR).

Generally, in addition to the conditions set out above, foreign securities will be admitted for placement (initial sale to initial investors) in Russia provided that the prospectus describing such securities is registered by the CBR and such securities are registered with (held through) a depositary established in accordance with Russian law. A filing of a notice to the CBR with the results of the initial placement in the Russian territory and disclosure of this information are required, without which any subsequent trading/transacting in Russia is prohibited.

In certain cases, a decision to admit foreign securities to public circulation in Russia may be made by the Russian exchange if a listing procedure is started or finished by the foreign exchange and which is included in the list specified by the CBR.

What are common issuing methods and types of debt securities?

It should be noted that Russian regulation of the securities market is rather conservative. Russian issuers can only issue the types of securities that are directly specified in the law and in accordance with the requirements stated in the law.

The most common types of Russian debt securities are bonds issued on a stand-alone basis. Recently, it also became possible to issue bonds under a program.
The various types of Russian debt securities include:

- bonds characterized by the type of interest or payment such as fixed-rate bonds, floating-rate bonds and discount bonds;
- secured bonds such as bonds secured by the pledge, bonds secured by surety and bonds secured by bank or state guarantee;
- subordinated bonds and perpetual bonds (i.e. bonds that have no specified redemption date);
- exchange-traded bonds;
- commercial bonds;
- structural bonds;
- Russian depository receipts (securities issued by a Russian depository evidencing the right of its holder to a certain amount of securities of a foreign issuer);
- warrants (securities giving its holder the option to purchase equity of the issuer under the terms specified in it); and
- convertible securities (securities convertible into other types of securities such as shares or bonds).

Foreign financial instruments can only be admitted to public placement/circulation if, among other requirements, they are qualified as securities under the procedure established by the Central Bank of the Russian Federation (CBR). Thus, the types of such securities are limited to those recognized by the CBR.

**What are the differences between offering debt securities to institutional / professional or other investors?**

In some cases, securities can only be offered to qualified investors. Such offerings are possible without a prospectus and disclosure of information (but it is still required for listing by an exchange).

Securities for qualified investors can only be acquired or sold through a broker in some cases.

**When is it necessary to prepare a prospectus?**

Under Russian law, a prospectus must be prepared in all cases, unless one of the following exemptions apply:

- securities are placed with qualified investors or the persons that can exercise a preemptive right in respect of such shares or securities (convertible into shares);
- shares or securities convertible into shares are placed with persons that, as on a certain date, are or were shareholders of the issuer;
- securities are offered to a maximum of 150 persons (qualified investors and persons that can exercise a preemptive right in respect of such securities not counted);
- funds raised by the securities offerings during a year do not exceed RUB 4 billion for a credit organization or RUB 1 billion for all other issuers;
- funds paid by each potential purchaser (apart from the persons exercising their preemptive right) are not less than RUB 1 million 400 thousand; or
- registration of separate terms and conditions of bonds under a program where a prospectus has been registered simultaneously with registration of the program within one year from the date of registration of the prospectus.

**What are the main exchanges available?**
The Moscow Exchange has two principle markets on which debt securities are traded subject to its rules:

- the Equity Capital Market which offers trading in shares, depository receipts, fund shares, mortgage participation certificates and exchange traded funds; and
- the Debt Capital Market which offers trading in state bonds, corporate bonds, and corporate and sovereign Eurobonds.

Another active exchange in Russia is the Saint-Petersburg Exchange where shares, options and commodities are traded. It is notable that, for the first time on the Russian market, the Saint-Petersburg Exchange has introduced an opportunity to trade foreign securities within the Russian jurisdiction.

Is there a private placement market?

Russia has a moderately active private placement market.

As a matter of Russian law, securities cannot be placed (including private placements through private offering to specified potential buyers) until:

- the securities offering and (in relevant cases) the prospectus are registered with the Central Bank of the Russian Federation; or
- issuing of the securities (at the time of incorporation of the issuer or through private offering) is registered by a licensed registrar, an exchange or a depository.

Are there any other notable risks or issues around issuing or investing in debt securities?

Generally, it should be noted that issuing or investing in securities in emerging markets such as the Russian Federation is subject to greater economic, political and legal risks when compared with more mature markets.

Potential legal risks are connected with the fact that regulation of the securities market in Russia is rather new and undeveloped in some spheres. The relevant laws tend to change rapidly and their practical implementation may be inconsistent or unclear. Some important areas of the securities market are not regulated in Russia, while in other areas the law imposes obligations on the Russian issuers which are not common in other markets. The approach of the Russian regulator and interpretations of the applicable legislation are unstable, not well developed and, at times, can be unpredictable and selective.

Issuing debt securities

Failure to comply with the stated requirements of proper information disclosure including misleading statements in, or omissions from, a prospectus can lead to civil, administrative or criminal liability. Federal Law 'On Protection of Rights and Legitimate Interest of Investors on Securities Market' provides various measures for the protection of investors.

Investing in debt securities

The concept of a bonds trustee (which is not a trustee in common law terms but a representative that acts on behalf of, and in the interests of, the bond holders) was recently introduced to the Russian securities market. The law provides the bonds trustee with significant discretion, while being in some parts vague and not widely tested in practice. Some bonds trustees on the market may interpret the law differently leading to uncertainty among investors.

The law also introduced a concept of investors meetings which consider matters affecting the investors interests. The decision of any such meeting is binding upon all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the decision.
Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally, under Russian law, a fund may be established in one of the following ways:

- as an investment fund in the form of a Russian joint-stock company (JSC Investment Fund); or
- as a mutual fund being a separate portfolio of assets which does not hold the status of a legal entity (Mutual Fund).

To perform its investment activities, a JSC Investment Fund must obtain a special license from the Central Bank of the Russian Federation (CBR) and meet certain other criteria established by Russian law, such as keeping a certain level of its own funds, holding a separate bank account for all its operations connected with trust management or meeting specific corporate governance requirements. Furthermore, it is worth noting that the JSC Investment Fund is not allowed to place any securities, except for its ordinary shares.

Although a Mutual Fund itself is not a legal entity, the law requires that its assets portfolio be managed under a trust management agreement by a special management company holding a CBR license. The law contains specific rules that apply to such management companies and trust management agreements, for instance a management company is required to register the rules of trust property management with the CBR or maintain certain financial levels.

What are common fund structures?

Russian law recognizes the following categories of mutual funds:

- opened mutual funds (investment units may be purchased or sold at any time);
- exchange traded mutual funds (investment units can be sold at an exchange or to the person authorized by the fund itself);
- interval mutual funds (investors may sell their investment units only in specified time periods); and
- closed mutual funds (investors cannot sell their investment units until the time period for which a fund was established expires).

An investment declaration of a joint-stock investment fund, an interval mutual fund or a closed mutual fund may also provide (or must provide in cases established by the Central Bank of the Russian Federation) that the shares/ investment units of such fund are designated for qualified investors.

Furthermore, depending on the type of investment, common fund structures also include share funds, bond funds, commingled funds, index funds and real estate funds.

What are the differences between offering fund securities to professional / institutional or other investors?

Russian law establishes that certain types of securities may be offered to qualified investors only. There is also a general prohibition on offering foreign securities and foreign financial instruments that are not admitted for public placement/circulation in Russia by the exchange, or, in certain cases – the CBR to an unlimited group of persons, or to persons who are not qualified investors.

The term ‘offering/offer’ is understood very broadly. According to informal opinions of the predecessor of the current regulator (the Federal Service for Financial Markets which is the predecessor of the Central Bank of the Russian Federation in the sphere of financial market regulation), an ‘offer’ is in essence ‘advertising or proposing’ and ‘it is not allowed to disseminate within the Russian Federation in any way, in any form and by any means, information that (i) is addressed to an unlimited number of persons or to persons that are not qualified investors and (ii) is aimed at (a) drawing attention to foreign financial instruments that are not admitted for public placement and/or public circulation in Russia, (b) creating and supporting interest in such securities and (c) promoting them in the market’.

Considering the above, active marketing/distribution of foreign financial products is possible only if such financial instruments have obtained appropriate authorization for public placement/circulation in Russia by the exchange, or, in certain cases – the CBR. If a financial
instrument has not been authorized for public placement/circulation in Russia, it may only be offered to qualified investors.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

Establishing a fund requires a special license (for the fund itself in case of a joint-stock company investment fund or its management company in case of a mutual fund), meeting license rules and complying with certain reporting and public disclosure requirements throughout the operation of the fund. For more information, see Establishing and investing in debt and hedge funds – establishment.

**Investing in funds**

Before investing in a fund, it is essential to check for specific requirements which may apply to investment in the fund by virtue of law or in accordance with rules of the specific fund, for instance to verify whether investment units are designated for qualified investors only or may be offered to general public.

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**Managing and marketing debt / hedge funds**

**Are there any restrictions on marketing a fund?**

Federal Law ‘On Advertising’ sets requirements for the advertising (that is, the distribution of information addressed to the general public and intended to draw attention to an object of advertising, to form or keep up an interest to it or to market it in any form) of financial services or financial activities of a fund or the advertising of securities, such as a prohibition on the inclusion of information about the assets management that is not supported with documentary evidence, as well as the guarantees of future stability and / or profitability of the investments, unless it can be clearly defined at the time of agreement for using such financial services.

Russian law also prohibits offering foreign securities and foreign financial instruments that are not admitted for public placement/circulation in Russia to an unlimited group of persons, or to persons who are not qualified investors.

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**Are there any restrictions on managing a fund?**

Activities of joint-stock investment funds, and management of joint-stock investment funds or mutual funds, require a license issued by the Central Bank of the Russian Federation.

Since the activities of funds are heavily regulated in Russia, there are various restrictions on the management of funds. For example, a management company cannot acquire assets which are not listed in the law and the investment declaration of an investment fund. Compensation of the management company cannot exceed 10% average annual net asset value of the investment fund.

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**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

A person entering into a derivative contract by way of business must have a license for banking operations or a license of a professional participant on the securities market (in particular, for brokerage or forex dealer activities) whereas entering into derivatives contract intended for qualified investors is possible only through such persons. Entering into such contracts on an organized exchange is possible where the other party to the agreement is a central counterparty.
The Civil Code of the Russian Federation also regulates deals where there is an obligation on a party to pay monetary amounts depending on the changing price of:

- goods;
- securities;
- exchange rates;
- interest rates;
- inflation rates;
- parameters calculated as an aggregate of the indicators specified above; or
- an occurrence of any other event provided by the law where it is not known whether such event will happen or not.

The claims in respect of such deals are only subject to court protection if at least one of the parties is a legal entity with a license for the banking operations or professional activities on the securities market or, if the deal is made on an authorized exchange, at least one party is a legal entity with a license authorizing it to make deals on an organized exchange. If an individual is a party to such deal, court protection will only be provided if such deal has been made on an organized exchange or in other cases directly stated in the law.

What are common types of derivatives?

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are used in Russia:

- forwards;
- futures (most wide-spread and popular);
- swaps; and
- options (call options and put options).

The value of the derivative contract is based on the value of the underlying assets which, among others, may be:

- securities;
- commodities;
- foreign currency;
- interest rates;
- inflation rate; or
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

Over-the-counter derivative contracts, unlike those made on an organized exchange, do not have any system of centralized control, guarantees of performance, risk-management system or requirements on the participants. This risk analysis is carried out by the market player itself.

However, at the moment the Central Bank of the Russian Federation is developing amendments to the relevant laws in order to mitigate the mentioned risks and improve the infrastructure of the over-the-counter derivatives market, including centralized clearing.
accreditation of price centers and repository activities. In particular, in 2019 the CBR introduced its new approach to further enactment of the new rules for variation margin for non-exchange traded derivatives that should be put into effect in several stages. This area of law is therefore subject to possible changes.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

A credit agreement in Russia can take two forms:

- a credit facility agreement (the creditor can only be a bank or other credit organization, and the subject matter of such agreement can only be monies); or
- a loan agreement (the creditor can be any other non-credit organizations, including individuals, and the subject matter of such agreement can be monies or other things of general description or securities).

A loan agreement where a creditor is an individual is considered concluded only after monies or other things of general description are transferred to the other party, not after its execution. In other cases such contracts shall be deemed to be concluded on their execution date.

Not all forms of lending activities are regulated, such as loans between individuals.

However, in order to perform operations related to lending activities, the banks and non-banking credit organizations are required to obtain a license from the Central Bank of the Russian Federation (CBR).

Professional consumer lending is only allowed for credit organizations and a number of non-credit financial organizations specified in the law (microfinance organizations, credit cooperatives and pawnshops) and included in a relevant list by the CBR. There are also regulatory requirements stated in the Federal Law 'On Consumer Credit (Loan)' that apply to such professional consumer lenders.

Federal Law 'On Consumer Credit (Loan)' sets out restrictions on credit agreements secured by mortgage which are entered into by a borrower with a non-business related purpose, such as restrictions on the maximum amount of penalties and the amount of the total charges for the credit agreement.

Borrowing

While borrowing is generally not regulated, it is advisable for borrowers to consider whether either the consumer lending or mortgage regimes apply to their activities, in which case they will benefit from the protections mentioned above.

However, the law states some specific restrictions in respect of borrowing, such as:

- an individual declared bankrupt cannot borrow without indicating this fact to the counterparty for five years; and
- there is a general prohibition on borrowing for management companies of investment funds.

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What are common lending structures?

A credit agreement in Russia can take the form of a credit facility agreement or a loan agreement. For more information, see Lending and borrowing – restrictions.

A credit facility agreement, being the most common lending instrument in Russia, may be structured in a number of ways to include a
variety of features depending on the commercial needs of the parties. A loan agreement is used between individuals or non-credit organizations that only occasionally (not on a regular basis) lend their funds to other parties.

A credit facility agreement is usually provided on a bilateral basis (a single lender providing the entire facility); however, syndicated facility agreements with multiple lenders providing parts of an overall facility are also used on the basis of Federal Law 'On Syndicated Credit (Loan) and Amendments to Certain Legislative Acts of the Russian Federation'. It should be noted that Russian law does not recognize the concept of a trust, thus alternative structures, such as a credit agent (kreditnyj upravlyayushiy), are used in syndicated secured transactions.

**Loan durations**

There are no particular requirements as to the duration of credit agreements.

Depending on the commercial needs of the parties, the credit agreements may take the form of a term agreement (provided for an agreed period of time), revolving agreement (provided for an agreed period of time with an availability period to extend nearer to maturity of the agreement and which may be redrawn if repaid), etc.

**Loan security**

A credit agreement can be either secured or unsecured. For more information, see Giving and taking guarantees and security.

**Loan commitment**

In the case of a credit facility agreement a lender cannot refuse to provide the loan unless there are circumstances evidencing that the loan will not be repaid in the due time. However, in accordance with the long-standing position of Russian courts, a breach of the respective obligation by a creditor will not give rise to the remedy of specific performance; ie a debtor will not have an enforceable right against the creditor to demand the provision of a loan but will have to resort to the remedies of rescission and damages. It is also possible to formulate conditions precedent for such refusal in the credit facility agreement itself.

A lender under the loan agreement is obliged to provide the loan unless there are circumstances evidencing that the loan will not be repaid in the due time with the exception of cases where a lender is an individual (please see Lending and borrowing – restrictions).

**Loan repayment**

A credit facility or a loan can be repayable on demand, on an amortizing basis (in installments over the life of the loan) or scheduled (usually meaning the facility or loan is repayable in full at maturity).

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to individuals for non-business related purposes, including mortgage lending, is subject to regulatory restrictions under Federal Law 'On Consumer Credit (Loan)', which are not applicable to institutional and professional borrowers. For more information, see Lending and borrowing – restrictions.

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**Do the laws recognize the principles of agency and trusts?**

The principles of agency are recognized in Russia. For instance, it is possible to appoint an agent to act on behalf of other parties.

The concept of trust, on the other hand, is not recognized under the Russian law, thus alternative structures (such as a credit agent (kreditnyj upravlyayushiy)) are used in syndicated secured transactions.

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Are there any other notable risks or issues around lending?

Generally

Credit agreements are subject to general contractual principles. For example, parties must agree on all the essential terms of the relevant type of agreement specified in the law, otherwise the agreement will be deemed unconcluded.

It should be noted that a penalty stated in the agreement may be lowered by the court where it is evidently disproportionate to the consequences of the breach.

Under Russian law a pledge cannot be enforced if the breach of the secured obligation is insignificant and the amount of the claim as a result of this is evidently disproportionate to the value of the pledged property. It is presumed that the breach is insignificant if (i) the overdue amount is less than 5% of the value of the pledged property and (ii) the late payment period is less than three months. In addition, in some cases the court may postpone the enforcement of the pledge.

In case of the pledgor’s bankruptcy the pledgee receives only 70% (or 80% for claims under the credit facility agreement) of the funds derived from the enforcement of the pledge in priority. Any remaining claims will be satisfied in the general order.

Specific types of lending

In respect of credits for non-business related purposes, there is more legal protection for the borrower than in the case of corporate credits. The law includes some restrictions specific to consumer lending and mortgage lending to individuals for non-business related purposes. For example, the maximum amount of total charges for credit and the maximum amount of penalties for non-performance or breach of the borrower’s obligations are regulated by law, while some services are provided to individuals free of charge.

Standard form documentation

In 2015 the Association of Russian Banks has developed and published a standard Russian-law governed syndicated credit facility agreement which does not include the newer requirements of Federal Law ‘On Syndicated Credit (Loan) and Amendments to Certain Legislative Acts of the Russian Federation’, however in any case such syndicated facilities are rare. For transactions with a foreign counterparty it is common to choose English law as the governing law and to use Loan Market Association standard forms.

Bilateral finance transactions are more likely to be documented on bank standard form documentation.

Are there any other notable risks or issues around borrowing?

No other notable risks.

It should be noted that there are special types of crimes in respect of borrowing stated in the Criminal Code of the Russian Federation, such as:

- fraud in the sphere of lending;
- unlawful receiving of a credit; and
- malicious avoidance of credit repayment.

The type of punishment varies in respect of each crime. The maximum prison sentence is ten years.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?
As a matter of Russian law, a guarantee is not regulated separately – it is one form of security which shares common features with other forms of security.

Some of the key areas affecting the giving of security are as follows.

**Form of a contract**

Granting security that breaches certain mandatory form requirements specified by the law will lead to its invalidity. The requirements differ depending on the type of the security. For example, a pledge of a participation interest must be notarized, while agreement on penalty must be in writing regardless the form of the primary obligation.

**Insolvency**

For a period after a new security interest has been granted (known as the hardening period), security may be at risk of being set aside under Russian insolvency laws if the security was granted within a certain time period prior to the insolvency of a company and a company received considerably less consideration for it or if a deal was made with the purpose of prejudicing the property rights of the creditors. Another ground for setting security aside is where the court qualifies the deal as leading to preference of one creditor over the other creditors.

**Subsequent pledge**

Pursuant to recent changes to the law, a subsequent pledge cannot be prohibited by the first ranking pledge agreement. However, if a first ranking pledge agreement specifies the terms on which a subsequent pledge is to be concluded, the breach of such terms entitles the first ranking pledgee to claim from the pledgor compensation of any losses incurred by such breach.

**What are common types of guarantees and security?**

There are various methods of securing performance of obligations under the Russian law.

The common types of security interest include:

- pledge (including mortgage);
- surety (note that the surety and the debtor shall be jointly liable to the creditor unless the surety agreement or law provides for secondary liability);
- independent guarantee (a written guarantee issued by a bank or other legal entity to pay the creditor a certain amount of money irrespective of the validity of the obligation secured by this guarantee);
- security payment (a sum of money paid by one party to another party to secure a monetary obligation, including the obligation to pay a penalty for breach of contract and certain other specific types of obligations);
- penalty (a sum of money which the debtor is obliged to pay to the creditor in the event of its failure to discharge its obligations); and
- retention (a creditor has the right to retain tangible property in its custody in the event that the debtor fails to discharge its payment obligations relating to the property).

**Are there any other notable risks or issues around giving and taking guarantees and security?**

To be valid, security shall comply with the following form requirements:

- An agreement on a penalty must be in writing regardless the form of the primary obligation.
- A pledge can be created by a written agreement or by operation of law (in this case the parties may conclude a written agreement
regulating their relationship). The pledge of participation interest must also be notarized.

• A surety agreement must be in writing (in some cases it can be created by operation of law).

• An independent guarantee must be granted in a written form that allows for the identification of the terms of a guarantee and to ascertain its authenticity.

The law also states compulsory registration requirements for certain types of pledge that are not created until such registration is made:

• A pledge of participation interest must be registered in the official single register of the legal entities.

• A mortgage (pledge of immovable property) as an encumbrance over the real estate must be registered in the unified state register of real estate.

• For a share pledge, a transfer record must be made on the account on which the rights of the shares owner are recorded.

There is also a register of notifications on the pledge of movable property which is maintained by the notary public. Registration of the pledge is not compulsory but the pledgee is only entitled to refer to the pledge in its relations with the third parties if registration is made. Moreover, regardless of the time the pledge was created, priority will be given to the claim under a pledge which has been registered first.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Civil Code of the Russian Federation, Part I ([1]) (general provisions of civil law)

Civil Code of the Russian Federation, Part II ([2]) (distinct types of obligations)

Civil Code of the Russian Federation, Part III ([3]) (succession law and international private law)

Federal Law ‘On Securities Market’ ([4]) (securities market)

Federal law ‘On Banks and Banking Activities’ ([5]) (banks and banking activities)

Federal law ‘On Foreign Investments in the Russian Federation’ ([6]) (foreign investments)


Consumer credit

Federal Law ‘On Consumer Credit (Loan)’ ([9]) (consumer lending)

Federal Law ‘On Microfinance Activities and Microfinance Organizations’ ([10]) (micro financing)

Federal Law ‘On Credit Histories’ ([11]) (credit histories)

Federal Law ‘On Protection of Rights and Legitimate Interests of Individuals In Activities of Collection of Overdue Repayment of Debts and
Amendments to Federal Law ‘On Microfinance Activities and Microfinance Organizations’

**Mortgages**

Federal Law ‘On the Mortgage (Pledge of Immovable Property)’

**Corporations**

Federal Law ‘On Joint-Stock Companies’

Federal Law ‘On Limited Liability Companies’

Federal Law ‘On International Companies and International Funds’

**Funds and platforms**

Federal Law ‘On Investment Funds’

Federal Law ‘On Investment Partnership’


**Other key market legislation**

Federal Law ‘On Currency Regulation and Currency Control’

Federal Law ‘On Concession Agreements’


Federal Law ‘On Anti-money Laundering and Counter-Terrorism Financing Measures’


Federal Law ‘On the Non-governmental Pension Funds’

Federal Law ‘On Syndicated Credit (Loan) and Amendments to Certain Legislative Acts of the Russian Federation’

**Regulatory authorization**

**Who are the regulators?**

The Central Bank of the Russian Federation is the main regulator of the financial and investment market. Its functions, among others, include:

- banking supervision;
- regulating activities of non-banking credit organizations;
- supervision of corporate relations by joint-stock companies;
- regulation and supervision of the securities market and activities of the professional participants on the securities market;
- organization and performance of currency regulation and control;
What are the authorization requirements and process?

There are several types of authorization. Depending on the nature of the business a person may be required:

- to obtain a license from the Central Bank of the Russian Federation (CBR);
- to obtain a permission from the CBR;
- to obtain accreditation from the CBR;
- to be added to a register by the CBR; and
- to be a member of a self-regulated organization.

The process and application fees vary depending on the type of authorization.

The CBR maintains and publishes lists of licenses and authorized persons on its official website.

What are the main ongoing compliance requirements?

Threshold conditions (such as a requirement as to the amount of funds held, meeting liquidity ratios and disclosure of information) are an ongoing compliance requirement for most types of authorized persons.

Failure to comply with the threshold conditions and other regulatory rules can result in sanctions being imposed, including loss of authorization.

What are the penalties for failure to be authorized?

Undertaking regulated activities without appropriate authorization can lead to an administrative fine for individuals or legal entities. It can also constitute a criminal offence resulting in a criminal fine, compulsory community service, compulsory labor, arrest for up to six months or imprisonment for up to five years. Performing banking operations without a license is a separate criminal offence with a maximum punishment of seven years’ imprisonment.

In addition, a legal entity acting without authorization may be liquidated by the court and/or have the proceeds of its activities confiscated by the state.

Regulated activities

What finance and investment activities require authorization?

Generally

- organization and methodological support of official statistical recording of direct investments;
- control of compliance with the requirements of the insider trading regulation;
- protection of rights and legitimate interests of shareholders and investors on the financial markets; and
- regulation, control and supervision of insurance activities;
- control over the activities of investment platforms operators.
Certain types of activities are subject to licensing by the Central Bank of Russian Federation (CBR), including:

- performance of banking operations;
- organization of an exchange;
- professional activities on the securities market (brokerage activity, dealer activity, forex-dealer activity, depository activity, repository activity, securities management and maintenance of a securities owners register);
- activities of joint-stock investment funds and non-governmental pension funds; management of joint-stock investment funds, mutual funds and non-governmental pension funds; special depository of joint-stock investment funds, mutual funds and non-governmental pension funds; and
- clearing and insurance activities.

CBR's permission must be obtained, for example, in order to establish a credit organization with foreign investments in Russia, for a Russian credit organization to establish a branch or subsidiary abroad, or for Russian issuers to issue securities abroad.

Accreditation by the CBR is required for representative offices of foreign credit organizations, informational agencies that disclose information on the securities markets, and others.

Some types of activities can only be performed after a firm is added to the official register by the CBR (such as microfinance organizations, credit rating agencies or investment platforms operators) or after it enters into a self-regulated organization on a financial market.

**Consumer credit**

Consumer credit activities are generally performed by credit organizations (which include banks and non-banking credit organizations that are only allowed to perform a limited number of banking operations). Consumer credit activities can also be performed by some non-credit financial organizations, such as microfinance organizations, credit cooperatives or pawnshops.

The performance of banking operations by credit organizations requires a license from the CBR, while non-credit financial organizations must be added to a register of authorized organizations maintained by the CBR.

Federal Law 'On Consumer Credit (Loan)' sets out the framework for consumer credit and contains restrictions and implied terms which protect an individual.

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**Are there any possible exemptions?**

If regulated activities are performed in the territory of Russia, they require an appropriate form of authorization with no exemptions.

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**Do any exchange controls or other restrictions on payments apply?**

Cross-border transfers and the use of foreign currency in the territory of Russia is allowed only in the cases specified in the Federal Law 'On Currency Regulation and Currency Control'.

In general, currency operations between residents are prohibited unless expressly allowed by law. Currency operations between residents and non-residents may be performed subject to certain requirements (payments must be settled through an authorized bank and registrations of cross-border trade and loan/credit contracts by such a bank must take place).

The law also obliges residents to 'repatriate' the currency earnings, meaning that they as a general rule must facilitate the full return by non-residents of foreign currency or Russian currency due under the terms of the relevant foreign trade or loan contract to the resident's bank account opened with the authorized bank. Non-compliance with this rule can lead to an administrative or criminal liability.

Non-residents may open accounts with Russian banks and transfer funds to and from such accounts without restriction. Residents are also allowed to open accounts with foreign banks but generally there is a requirement to report this to the tax authorities. Operations under such accounts are subject to certain restrictions stated in the law.
There may also be anti-money laundering and tax considerations to take into account.

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What are the rules around financial promotions?

Rules

Russian law does not specifically define financial promotions. However, there are relevant provisions in legislation regarding advertising, the issuance and operations of financial instruments and the provision of financial services.

Under Federal Law ‘On Advertising’, any advertising (that is, the distribution of information addressed to the general public and intended to draw attention to an object of advertising, to form or keep up an interest to it or to market it in any form) of financial services or financial activities that requires authorization can only be done by an authorized person.

It is also unlawful to advertise and/or offer to the general public the securities of issuers who have not disclosed information in the order and scope specified by law. Russian law also stipulates that certain types of securities may be offered to qualified investors only.

Foreign securities which are not admitted to public placement/circulation in Russia and foreign financial instruments which are not qualified as securities under Russian law cannot be offered in any form or by any means (including advertising) to the general public or to persons who are not qualified investors. The term ‘offering/offer’ is understood very broadly. According to informal opinions of the predecessor of the current regulator (the Federal Service for Financial Markets which is the predecessor of the Central Bank of the Russian Federation in the sphere of financial market regulation), an ‘offer’ is in essence ‘advertising or proposing’ and it is not allowed to disseminate within the Russian Federation in any way, in any form and by any means, information that (i) is addressed to an unlimited number of persons or to persons that are not qualified investors and (ii) is aimed at (a) drawing attention to foreign financial instruments that are not admitted for public placement and/or public circulation in Russia, (b) creating and supporting interest in such securities and (c) promoting them in the market.

Generally, foreign securities may be admitted for placement (initial sale to initial investors) in Russia provided that the prospectus describing such securities is registered by the Central Bank of the Russian Federation (CBR) and such securities are registered with (held through) a depositary established in accordance with Russian law. A filing of a notice to CBR with the results of the initial placement in the Russian territory and disclosure of this information are required, without which any subsequent trading/transacting in Russia is prohibited.

Foreign legal entities and their representative offices and branches cannot perform activities of non-credit finance organizations including activities of professional participants on the securities market, offer services of foreign legal entities on the financial markets or distribute information about such entities and their activities to the general public in the territory of Russia.

Violations of the stated requirements can lead to a civil and administrative liability or loss of authorization.

Exemptions

Public placement (initial sale to initial investors) of Russian securities is generally allowed after the registered prospectus is made available to the public. If securities are designated for qualified investors, then in some cases it is possible to place them without a prospectus.

Public circulation, including offering to the general public, of Russian securities also requires compliance with the disclosure of information requirements. These rules may not be applicable to securities for qualified investors.

Foreign securities which are not admitted to public placement/circulation in Russia and foreign financial instruments which are not qualified as securities under Russian law can only be offered to qualified investors.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?
Generally

The most common types of legal entities are joint-stock companies (JSC) and limited liability companies (LLC), both of which are body corporates with separate legal personality.

The charter capital of a JSC is divided into shares and the liability of each shareholder is limited by value of its shares. The charter capital of an LLC is comprised of participation interests, the value of which also limits the liability of a participant. JSCs and LLCs are similar in many ways but differ in that LLCs are easier to establish and maintain, and are more flexible with respect to corporate governance.

Companies can either be public (where the shares of a JSC or other securities convertible into shares are placed through a public offering or are traded on a stock exchange) or private (all other JSCs and LLCs). Some activities require a particular type of legal entity to be used, such as the public offering of shares or other securities convertible into shares which can only be done by public JSCs.

Funds

Generally, under Russian law a fund may be established in one of the following ways:

- as an investment fund in a form of a Russian joint-stock company; or
- as a mutual fund being a separate portfolio of assets which does not hold the status of a legal entity.

Management companies of investment funds can be Russian JSCs or LLCs only.

Is it possible to conduct lending or investment business through a branch or establishment?

In Russia it is possible to establish a representative office or a branch. Both are separate divisions of a legal entity and do not create a separate legal personality.

Representative offices are not allowed to undertake commercial activity under the Civil Code of the Russian Federation. Instead, their main purpose is generally to promote commercial relations between the legal entity which they represent and Russian enterprises, and to gather information about the Russian market. Branches may undertake commercial activity, including lending or investment business, and fulfill all or part of the functions of its founding legal entity, provided the founding legal entity is authorized to carry out such activities.

However, foreign legal entities and their representative offices and branches cannot perform activities of non-credit finance organizations including activities of professional participants on the securities market, offer services of foreign legal entities on the financial markets or distribute information about such entities and their activities to the general public in the territory of Russia.

In relation to foreign credit organizations, in Russia it is only possible to establish representative offices of such foreign credit organizations (including banks); branches are not allowed. As mentioned above, representative offices cannot perform commercial activities.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

General
According to the latest reports, Russia is one of the leading and fast-growing FinTech markets with approximately 82% of major cities’ populations actively using, or at least being familiar with the most common technology products (EY, 'Global FinTech Adoption Index 2019'). Core FinTech products in Russia currently include online payments, mobile transfers, electronic banking, insurance utilizing telematics and automatic financial planning.

The following is an overview of the developing FinTech products based in Russia and their prospects in the near future.

### Online wallets, payments and money transfers

Digital currency is a non-bank form of electronic payments and money transfers, which provides a prompt, simple and cost-efficient way of conducting monetary transactions without relying on the intermediary of a bank. Account (‘wallet’) services, as well as the other parts of infrastructure are provided by the issuer of the currency, with the latter generally not being limited to inter-user operations, but allowing the transfer to either another wallet or a bank account. While digital currencies are capable of performing most traditional bank account functions, their most prominent areas of application are online currency exchange and cross-border transfers, where banks’ fees for the respective services are significantly higher.

### Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

**HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?**

Marketplace lending includes peer-to-peer (P2P)-type structures, often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds, as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

**THE CURRENT POSITION OF PEER-TO-PEER FUNDING AND ITS PERSPECTIVES**

Marketplace lending is available to address most forms of traditional bank funding products. Recent products have included:

- consumer loans;
- small and medium-sized enterprises (SME) lending; and
- debt refinancing.

It is likely that the volume of lending in these and additional product areas, will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector and lawmakers become increasingly more motivated to create a legal framework for the sector. To date, the further development of the market is currently has been hindered by the lack of certainty regarding the different platforms’ legal standing and unavailability of uniform credit history and rating. It may be expected that in light of recent adoption of Federal Law “On Raising Investments via Investment Platforms and on the Amendments to Certain Legislative Acts of the Russian Federation” (Crowdfunding Law) that uncertainty will decrease to some extent and market players will become more open to the growing peer-to-peer sector.

### Blockchain, smart contracts and cryptocurrencies

**WHAT IS BLOCKCHAIN?**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable
WHAT IS A CRYPTOCURRENCY?

One of widely accepted definitions of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform).
although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency). The legal framework regulating this new form of virtual money is yet to be developed.

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

The current ICO sector is developing in Russia. Its future shape will significantly depend on the approach to be taken by the regulators who are working on the legal framework for the cryptocurrencies and ICOs. Recently adopted Crowdfunding Law allows for offering of certain crypto-assets via “investment platforms”, however, comprehensive framework for cryptocurrencies and ICOs is yet to be developed. Russian regulators are expected to develop their approach in the near future following recommendation by the FATF to adopt relevant legislation.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**
Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Central Bank of the Russian Federation (CBR) is the main regulator of the financial and investment market. Its functions, among others, include:

- banking supervision;
- regulating activities of non-banking credit organizations and some non-credit financial organizations;
- regulation and supervision of the securities market and activities of the professional participants on the securities market;
- regulation of payment services;
- organization and performance of currency regulation and control; and
- protection of rights and legitimate interests of investors on the financial markets.

A person must not carry on a regulated activity in the Russian Federation unless authorized. Where FinTech products or applications involve financial activity which requires regulatory authorization, the firms providing such products or applications must be authorized by the CBR.

Undertaking regulated activities without appropriate authorization can lead to an administrative fine for individuals or legal entities. It can also constitute a criminal offence resulting in liability ranging from a criminal fine, to imprisonment for up to five years. In addition, a legal entity acting without authorization may be liquidated by the court or have the proceeds of its activities confiscated by the state.

Innovations

In 2016 the CBR set its course on embracing the recent trends in the financial market, starting with the launch of association ‘FinTech’ (a collaboration of the regulator and major finance and technology players) and creation of the Financial Technologies Department. The purpose of both projects is to encourage further development of the market's technological segment and to monitor significant developments in the sector.

In 2018 the CBR made further steps to embrace FinTech: its "Main Directions of Development of Financial Technologies for 2018 – 2020" envisaged a number of strategies for development of FinTech, RegTech and development of financial infrastructure. The CBR also launched a "regulatory platform" (or "regulatory sandbox") where innovative FinTech projects may be tested and implemented under the CBR's control.

Regulation of peer-to-peer lenders

A business carries out a regulated activity (requiring authorization by the CBR) if they provide funding for either individuals or businesses, where the total amount of indebtedness of a borrower does not exceed RUB 1 million and RUB 5 million, respectively (microloans). Such businesses have to be recognized by the CBR as either a microfinance company (an entity allowed to raise funds from high-net worth
individuals and companies and through the offering of certain qualifying bonds) or a microcredit company (an entity only allowed to attract the assets of its shareholders or companies). The more detailed regulatory requirements are provided by the Federal Law 'On Microfinance and Microfinance Organizations'. Any lending activity exceeding the abovementioned thresholds for microloans would require a regular credit institution license.

CROWDFUNDING LAW

The Crowdfunding Law which came into force on 1 January 2020 established a legal framework for peer-to-peer lending via online "investment platforms". An operator of such a platform needs to be incorporated in Russia and be included in the register of investment platform operators maintained by the CBR.

Subject to certain exceptions, companies are allowed to raise investments through investment platforms in the total amount not exceeding RUB 1 billion in a calendar year. The investments may be raised through borrowing funds, issuing tokens or "digital utility rights" and offering securities.

Certain limitations apply to investors acting on investment platforms: an individual may not make investments in the amount exceeding RUB 600,000 in a calendar year. Certain exemptions apply to this rule: for example, this limit is not applicable to sole entrepreneurs and qualified investors.

Regulation of payment services

The payment systems (including electronic payment platforms) operating in the Russian Federation have to comply with the provisions of the Federal Law 'On National Payment System'. At present, more than 30 payment systems are functioning in Russia. All participants in a designated payment system will fall under the supervision of the Payment Systems Regulator (CBR), including, amongst others:

- operators that manage or operate the systems;
- the payment service providers using the system; and
- the infrastructure providers to the payment system.

Where a business enterprise provides payment services as a regular occupation or business activity in the Russian Federation, it will have to be recognized as either a bank or an authorized non-banking credit organization, thus requiring the license of the CBR.

ELECTRONIC PAYMENT PLATFORMS

Electronic money (e-money) is defined as 'monetary funds which are advanced by one person (provider of funds) to another person that records the information on the amount of advanced funds without opening a bank account for the purpose of discharge of payment obligations of the provider of funds to third parties and in respect of which the provider of funds is entitled to give instructions only with the use of electronic means of payments'. Generally, the firms issuing e-money must be licensed by the CBR.

Application of data protection and consumer laws

DATA PROTECTION

The Federal Law 'On Personal Data Protection' regulates the processing of personal data within the Russian Federation. Where a business determines the purposes and manner in which any personal data is collected, processed and stored, it will be regulated by the law and will be subject to certain notification and compliance obligations. Among other things, the businesses are required to localize the personal data in Russia and obtain consent for transfer of personal data abroad. The CBR Regulation 'On Data Protection in the course of Money Transfers' and the Government Decree 'On Data Protection in a Payment System' provide more detailed rules on data protection in the financial and investment market.

CONSUMER REGULATION

Professional consumer lending is only allowed for credit organizations and a number of non-credit financial organizations specified in the law (microfinance organizations, credit cooperatives and pawnshops) and included in a relevant list by the CBR. There are also regulatory requirements stated in the Federal Law 'On Consumer Credit (Loan)' that apply to such professional consumer lenders.

Money laundering regulations
The Federal Law ‘On Countering the Legalization of Illegal Earnings (Money Laundering) and the Financing of Terrorism’ give the Federal Service of Financial Monitoring (RosFinMonitoring) responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment.

Generally, where a firm is authorized and supervised by the CBR it will also be supervised by the RosFinMonitoring for complying with anti-money laundering requirements. Electronic currencies such as bitcoin and cryptocurrencies are yet to fall within the legal framework of money-laundering legislation, however, they are already considered by the Russian regulators to represent a higher risk, mostly due to the anonymous nature of transactions and lack of central control (decentralization).

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- **Equity crowdfunding (crowd-investing)** involves company shares being given in exchange for investment in the business.
- **Reward-based crowdfunding** provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

While most of the local crowdfunding platforms (Planeta.ru, Boomstarter) are in the early stage of development, the international sector is well established, and may be attractive for a Russian FinTech business in the early stages.

**ACCELERATORS**

There are several incubators or accelerators in the Russian market, which offer support, facilities and funding for startups, often in return for an equity stake. For example, Skolkovo, Generation S and Ideal Machine, offer both investment and mentoring by industry experts.

**GOVERNMENT GRANTS**

Several government grants are available to early stage companies. Grants are given to companies without any obligation to repay, but with some strings attached to the commercialization and transfer of the technology outside of Russia. The most active organizations that currently give out grants to Russian startups are the Skolkovo and Bortnik funds.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the
company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), secured against a company's assets including an equity element, allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

### Senior bank debt and capital markets funding (late stage)

#### SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis, depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

#### CAPITAL MARKETS FUNDING

The Russian Federation has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

### Incentives and reliefs

#### STATE INCENTIVES

There are several government measures designed to help small, early-stage companies:

- tax schemes (Simplified Taxation System and Patent Taxation system);
- state investments (financial aid);
- supervision reliefs (eg simplified accounting standards);
- property grants (working facilities); and
- information help.

#### IT COMPANIES

Russia-based IT companies engaged in software development and sales activities and/or provision of technical services for developed software, are eligible for reduced rates of mandatory contributions until 2019.

#### SKOLKOVO TAX INCENTIVES

Certain tax benefits are available to Russian companies that are residents of Skolkovo Innovation Centre. Generally, Russian companies can become a Skolkovo resident if they conduct qualifying research and development and innovation activities, and comply with certain other requirements. The main benefits are: profits tax exemption for ten years and reduced mandatory contributions.

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### Portfolio sales

#### Loan transfers and portfolio sales

*What are common ways of buying and selling loans?*

Buying and selling loans is common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common way of selling loans in Russia is by an assignment of rights. Assignment is allowed unless otherwise stated in law.
Generally, it can be done without the consent of the debtor.

Recently the Civil Code of the Russian Federation recognized the concept of an agreement transfer, which allows the transfer of all rights and obligations under an agreement to another party. However, it is not yet widely used in practice.

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**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by legal advisors. Some of the key considerations include the following.

**Contractual prohibition or restriction of assignment**

The parties may contractually prohibit or restrict an assignment. This does not invalidate the assignment and cannot be a ground for termination of such agreement, but the assignor is not exempt from liability before the debtor for such breach.

**Form of assignment**

An assignment shall comply with the same form requirements as the main agreement. For more information, see [Giving and taking guarantees and security – other issues](#).

**Assignment of security interest**

Generally, the assignment of rights under the main obligation means simultaneous automatic assignment of rights under the security. However, for the types of pledges that require registration (for more information, see [Giving and taking guarantees and security – other issues](#)) the new creditor will not be able to enforce such security until the registration is made.

**Data protection**

If an assignment requires transfer of the borrower’s personal data, there must be consent of the relevant borrower to disclose such personal data to third parties in case of assignment.

**Transfer mechanics**

If a loan agreement specifies a procedure for an assignment, this procedure shall be followed.

**Notifications**

Russian law does not require notifications to be made, but the new creditor bears a risk of any adverse consequences of non-notification. The obligation of a debtor ceases with performance to the original creditor if it is done before a notification has been received. The agreement itself may require notifications to the other parties and any such procedure must be complied with.

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**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Russia varies according to the asset class. Some publicly owned energy and infrastructure companies are still pending privatization in accordance with the relevant government plans.
Federal Law 'On the Procedure of Foreign Investment in Business Undertakings Strategically Important for National Defense and State Security of the Russian Federation' sets out the conditions and procedures allowing the Russian government to restrict, on a case-by-case basis, the right of foreign investors to take control of, or gain influence over, or acquire assets of companies engaged in some activities deemed strategically important for Russia's national defense or security. Some activities in the sphere of energy and infrastructure may fall into this category.

It should also be noted that in Russia the state owns the mineral resources in subsoil until they are extracted. The right to the extracted natural resources could be in any form of ownership depending on the entity exploring and developing subsoil in Russia under the relevant subsoil license.

**Energy**

As a result of reform, the electricity industry in Russia is partially privatized. The public joint-stock company 'The System Operator of the Unified Energy System', which is owned by the Russian Federation, exclusively performs centralized administration of the Unified Energy System of Russia. The electricity network companies are also owned by the state. However, generation and retail companies are now open to private (including foreign) investors.

The most significant participant of the gas industry in Russia is the public joint-stock company 'Gazprom' which is partially owned by the state. It has a monopoly to export pipeline gas, while the export of liquid gas is also allowed by some other companies.

**Telecoms infrastructure**

Under Federal Law 'On Communications', telecommunication networks and devices may be either public or private. At present, there is no particular law that lists the telecommunication networks and devices that may only be owned by the state although such a law may come into existence. In practice, telecommunication infrastructure is owned by several service providers.

**Transport infrastructure**

**RAIL**

The railroads in Russia are mainly owned and operated by the public joint-stock company 'Russian railroads', which is publicly owned. There are also railroads owned by private companies in remote areas which are used primarily for local cargo transportation.

**ROADS**

The roads (including construction elements placed on or over them, such as bridges or tunnels) in Russia are generally publicly owned. Private ownership is possible if a road is built by individuals or companies using their funds on land plots which have been provided to them specifically for these purposes, or where the roads are otherwise transferred into private ownership in accordance with Russian law.

**AVIATION**

Aviation is (for the most part) privatized.

**PORTS**

Certain elements of the ports infrastructure may only be publicly owned, such as approach channels or navigation equipment. Some infrastructure facilities which were produced or acquired using the funds of legal entities or individual entrepreneurs may be privately owned.

**Other infrastructure**

**EDUCATION**

Ownership of a school's infrastructure depends upon which category of school it belongs to. In respect of state and municipal educational organizations, their educational, production and social infrastructure cannot be privatized.
Typically, defense assets are owned by the state.

WASTE

The waste treatment infrastructure in Russia is mainly privately owned.

WATER

Water infrastructure in Russia is owned by the state, with limited exceptions for certain types of infrastructure.

Are there special rules for investing in energy and infrastructure?

Generally

In addition to the general methods of investing, there are also two special legal regimes in Russia that may be used for investments in energy and infrastructure.

A significant part of the investment in energy and infrastructure takes the form of public-private partnerships (PPPs). A PPP project is generally achieved through a long-term agreement between the public sector and the private sector to deliver a service traditionally provided by the public sector. Federal Law 'On Public Private Partnership, Municipal Private Partnership in the Russian Federation and Amendments to Certain Legal Acts of the Russian Federation' (PPP Law) applies to numerous types of infrastructure including, among others, roads, railways, pipelines, sea ports, airports, healthcare and education facilities. The PPP Law specifies essential elements of PPP agreements, tender and selection procedure and certain guarantees for the investors.

Another option is a concession agreement under Federal Law 'On Concession Agreements' (Concession Law). The Concession Law applies to various types of infrastructure, which are nearly the same as in the PPP Law (including, among others, roads, railways, pipelines, sea ports, airports, communal services, and various cultural, education, healthcare, sporting and tourism facilities). Generally, The main difference between the regulation provided under the Concession Law and the PPP Law is that in the case of a concession the newly created infrastructure object remains in the state ownership (as opposed to private ownership under the PPP Law), whereas a private partner typically is responsible for its maintenance and operations.

Federal Law 'On the Procedure of Foreign Investment in Business Undertakings Strategically Important for National Defense and State Security of the Russian Federation' sets out the conditions and procedures allowing the Russian government to restrict, on a case-by-case basis, the right of foreign investors to take control of, or gain influence over, or acquire assets of companies engaged in some activities deemed strategically important for Russia's national defense or security. Some activities in the sphere of energy and infrastructure may fall into this category.

In addition, a particular proposed investment may be subject to other legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which investment is to be made), the legal/regulatory position relevant to that project must be considered.

Energy

The energy market in Russia exists in the form of the Unified Energy System which is exclusively administered by the publicly owned public joint-stock company 'The System Operator of the Unified Energy System' (System Operator). There is a complex system of arrangements between the System Operator and other participants of the energy market which is heavily regulated, including, for example, statutory user fare regulation. Some types of activities would also require a special license.

Telecoms infrastructure

There is a complex regulatory environment for this sector as specified in Federal Law 'On Communications' as well as in regulations of the Government, the Ministry of Communications and Mass Communications of the Russian Federation and other regulatory bodies.

Transport infrastructure

Transport infrastructure also has an extensive and complex framework to consider. For example, in relation to rail,
understanding the regulatory regime for compulsory certification and declaration of conformity of the railroad infrastructure and user fare regulation. Aviation also has various licensing requirements and regulatory bodies requirements.

**Other infrastructure**

The regulation of PPPs and concession agreements in Russia is in many ways imperative. For example, the law restricts possible security instruments that the parties may choose (it is generally forbidden to pledge the project assets or the rights under concession agreement, however, certain exceptions exist in the latter case if the project is funded by external creditors) and the selection process. Russian policy favors the jurisdiction of the Russian court for the resolution of contractual disputes for such cases, which foreign investors may not be comfortable with.

_Last modified 5 Dec 2019_

**What is the applicable procurement process?**

Public procurement is regulated by the PPP Law and Concession Law. The key principles are that the contracts procured by the public sector shall be awarded fairly, transparently, without discrimination and that all bidders are treated equally.

**Investing in energy and infrastructure**

The public sector must publish a tender notice online or send the notifications to potential participants. The selection process differs for the opened and closed procedures.

Bid procedures normally allow the winning bidder to submit mark-ups during post-tender negotiations of key terms (for example the timetable to close the deal); however, to a significant extent, a winning bidder is still bound to the published version of the concession agreement. Potential amendments to the concession agreement cannot include the terms which were conditions of the tender or which were contained in the winning bid.

Apart from public tenders both the PPP Law and Concession Law allow private initiative from an interested investor. In this case the initiative on the project comes from a private partner that suggests the conditions of the concession agreement and key terms of the project implementation, which should comply with the effective laws. If the public partner is interested in the project and has general consent to the conditions it publishes the relevant notification for any other party, which may be willing to implement the project. If any alternative investors are interested in the project, then the tender selection procedures take place.

If an investor seeks to invest in a project that has already been procured and is operational, it should be noted that assignments under the concession agreements are possible only if approved by the public sector.

**Financing energy and infrastructure**

On a publicly procured contract, the public sector may prescribe requirements on the funding arrangements.

_Last modified 5 Dec 2019_

**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis;
- loans made on a project-finance basis (to a special purpose project company);
- bond finance;
- refinancing of debt; and
- asset financing (which is less common).
Investing

Common forms of investing in energy and infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests; and
- secondary market investment in operational projects (acquisition of 'equity').

Restructuring

Enforcement and sanctions

*When can there be regulatory investigations?*

The Central Bank of the Russian Federation may launch an audit if it considers that an authorized person may have breached the ongoing compliance requirements. This may result in regulatory sanctions.

*What regulatory penalties may apply?*

When a rule breach has taken place, the Central Bank of the Russian Federation (CBR) may impose a financial penalty, withdraw authorization or apply to the court for compulsory liquidation of a legal entity or for confiscation of all proceeds from unauthorized activities by the state. Some of these penalties will be published by the CBR.

*What criminal penalties may apply?*

The regulator itself is not allowed to impose criminal penalties, this can only be done by a court.

Criminal penalties may apply to certain actions specified in the Criminal Code of the Russian Federation, such as:

- performance of commercial activities without registration or a license;
- performance of banking operations without registration or a license;
- malicious avoidance of disclosure or distribution of information under the laws on the securities or distribution of knowingly incomplete or inaccurate information;
- market manipulation or insider dealing;
- fraud in the sphere of lending;
- unlawful receiving of a credit; and
- malicious avoidance of credit repayment.

Tax

Tax issues
**Are stamp, registration, transfer or other similar taxes applicable?**

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

The notarization of a transaction in connection with mortgage agreements, the subject of which should be certified, is required. The notary charges for notarization depending on the value of the transaction. For transaction values of:

- up to RUB 1 million (approx. USD16,000) – RUB 2,000 (approx. USD31) plus 0.3% of the contract value is payable;
- more than RUB 1 million and up to RUB 10 million (approx. USD150,000) – RUB 5,000 (approx. USD78) plus 0.2% of the contract value above RUB 1 million is payable; and
- more than RUB 10 million – RUB 23,000 (approx. USD360) plus 0.1% of the contract value above RUB 10 million, up to a maximum of RUB 500,000 (approx. USD7,800) is payable.

In addition, notaries usually charge fees for their technical services. The amount charged depends on the particular notary and the complexity of the transaction and may vary (usually no more than USD1,000). All United States Dollars equivalents specified are based on the exchange rate of the Russian Federation Central Bank at the time of writing.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security.

**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt holders take priority over the Federal Tax Service of the Russian Federation on enforcement of security.

**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Withholding taxes are only applicable in the context of cross-border operations, ie in the context of Russian-source income (in particular, interest payments under a loan) paid by a Russian legal entity (RLE) to a foreign legal entity (FLE). Accordingly, tax should be withheld by an RLE paying interest to an FLE.

In relation to domestic loan transactions (ie loans between RLEs), no tax is required to be withheld. Corporate income tax is paid by the lender as part of its total taxable income on the earned interest income as per the standard procedure.

If so:  
What is the rate of withholding?

Withholding is applied at the standard 20% corporate income tax rate on any interest income paid to a FLE.
What are the key exemptions?

The key reliefs and exemptions from withholding tax on interest income are as follows:

- a reduced rate of withholding for certain types of debt obligations (e.g., certain government securities, municipal securities and mortgage-backed securities);
- exemption or partial exemption under an applicable double tax treaty when interest income is paid to an FLE resident in a country that has concluded a treaty with Russia; and
- irrespective of the terms of a double tax treaty, certain interest payments are exempt from Russian withholding tax (e.g., interest income payable on certain government securities, municipal securities, and interest income which is paid by Russian organizations on marketable bonds issued in accordance with the legislation of foreign states).

As to application of the exemption under an applicable double tax treaty, the interest income's recipient must be (i) the beneficial owner of the Russian-sourced income and (ii) a tax resident in the corresponding tax treaty country. In particular, the beneficial owner of income is defined as a person who by virtue of (a) having participation interest (directly and/or indirectly) in an organisation; or (b) control over an organisation; or (c) by virtue of other circumstances has the right to independently use and (or) dispose of such income.

The beneficial owner must provide to a Russian company (the “tax agent”) certain documents confirming the beneficial ownership status, given that the tax agent pays the Russian-sourced income and is therefore responsible for remitting withholding tax on this income. The tax agent must keep these documents and provide them to the Russian tax authorities when requested. However, neither Russian tax law nor clarifications from competent authorities indicate which documents constitute proof of beneficial ownership status.

The Federal Tax Service and the Ministry of Finance have defined a wide range of criteria which, from a beneficial ownership perspective, should be taken into account when determining a taxpayer's entitlement to double tax treaty benefits. Therefore, a tax agent should analyze whether an FLE, which is a foreign recipient of Russian-source income is indeed the beneficial owner of such income based on such criteria, which are often differ from the OECD approaches.

Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g., by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes.

Key contacts

Karen Young
Partner
DLA Piper Rus Limited
karen.young@dlapiper.com
T: +7 495 221 4177
Senegal

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities both under OHADA Law and the Regulations of the CREPMF.

Under the General Regulation of the CREPMF, offer and sale of debt securities is subject to prior authorization of the CREPMF and the stamp of approval of the information notes.

Any proposed public offer for listed securities must be approved, in advance, by the Regional Council (Article 123).

An information note is to be drafted and must contain information according to the types of public offer in question and is subject to prior distribution.

When issuing public debt securities by a State or a group of States, their governments draw up an information note which is transmitted to the Regional Council before the date of issue of the securities.

That note is exempt from the prior visa before its distribution to the public.

The note for the issuance of public debt securities by local public authorities or guaranteed by a state or a group of states is subject to the prior visa of the Regional Council (Article 2 of Decision No. CM 05/09/2005 modifying article 136 of the General Regulations relating to the organization, operation and Control of the WAMU Financial Market).

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in the WAEMU are bills and bonds.

Other different types and forms include:

- asset-backed securities
- debt securities
- derivative securities
- hybrid securities such as convertible bonds
- equity-linked securities such as convertible bonds
- exchangeable bonds
Issuance of treasury bills and bonds

The issuance of Treasury bills and bonds (issued by the state, under the responsibility of the Minister of Finance) is subject to a tender or a syndication procedure, organized with the assistance of the WAMU Securities Agency (Agence UMOA-Titres).

Open tender: Primary subscription of treasury bills and bonds is reserved to credit institutions, brokerage firms and regional financial investors holding settlement accounts with the Central Bank. Other investors, whether they are private individuals or corporations, may also subscribe through credit institutions or brokerage firms established on the territory of the Union.

Targeted tender: states may decide to hold part of their issuance through targeted auctions restricted only to their primary dealers.

Any investor wishing to acquire the security put out to tender can subscribe through those primary dealers.

Issuance of Treasury Bonds by Way of Syndication is carried out in accordance with the applicable regulatory provisions as set out by the CREPMF.

What are the differences between offering debt securities to institutional / professional or other investors?

The main difference between offering debt securities to institutional/professional or other investors lies in the fact that institutional and professional investors are more experienced and sophisticated in understanding the information provided on the listing documents and make sound investment decisions.

Other investors, retail ones, need more detailed information and advice to be able to understand the investment documents and make sound financial decisions. They also need more protection from authorities entrusted with the regulation of the financial market.

There is, generally, no essential distinction between professional and other investors. However, one distinction lays on the channel through which financial securities are issued, for instance, bonds issued through public offerings and bonds issued on the market through auction.

When financial instruments are issued through public offerings, an investment syndicate made up of brokerage firms handles the sale to investors and the general public. After they are issued, they are listed on the BRVM.

As for financial securities to be issued through auction, primary subscription of treasury bills and bonds is restricted to credit institutions, brokerage firms and regional financial investors with settlement accounts with the Central Bank. Other investors, whether they are private individuals or corporations, may also subscribe to bills and bonds on the primary market through credit institutions or brokerage firms established on the territory of the Union.

Securities issued through auction are not listed on the regional stock exchange (BRVM).

When is it necessary to prepare a prospectus?

It is necessary to prepare an information note (concept used in the WAMU instead of prospectus) for any proposed public offer for listed securities which must be approved, in advance, by the Regional Council. It must contain specific information according to the types of public offer involved. (Article 123 of the General Regulations of the CREPMF).

When a state or a group of states intends to issue public debt securities, their governments draw up an information note which is transmitted to the Regional Council before the date of issue of the securities.

Any solicitation transaction must be accompanied by the sending or handing over to the solicited person of the information note or any other explanatory document, endorsed where appropriate, with the approval of the Regional Council before any initial issuance (Article 157).
What are the main exchanges available?

The Regional Stock Exchange (BRVM) is the main stock exchange available and it is shared by the eight member states of the WAEMU.

The stock market is divided into two markets which correspond to two levels: the primary market and the secondary market.

The primary market

The role of the primary market is to bring together companies looking for financings and capital holders.

The BRVM is regulated and issuers are to comply with different rules and regulations.

On the primary market, securities are issued by companies (issuers).

New issuance of securities is and may be done through the primary market during an IPO or a capital increase.

Securities issuance of a company that goes public can be done on the primary market and those securities may be purchased by investors. Those investors will then put those securities back up for sale on the secondary market.

The secondary market

The secondary market is far from being an active one. On the secondary market, stakeholders and investors exchange already issued (on the primary market) securities to be offered to savers. Investors will be able to trade these securities among themselves on the secondary market.

Transactions on this market are conducted through certified intermediaries such as banks, non-bank financial institutions, regional financial institutions, asset managers and brokerage firms.

Is there a private placement market?

Yes, there is a private placement market in Senegal and with the multiplication of private financial institutions in the WAEMU zone, more financing investments are thus being provided for companies and individuals.

That multiplication, combined with technological changes and developments, make access to offers and opportunities easier and more investments are being made through the private market in several sectors such as real estate and insurance.

There is no dominant standardization of private placement documentation. The ones from the Loan Market Association (LMA) are sometimes used.

Are there any other notable risks or issues around issuing or investing in debt securities?

Risks are of different types:

Foreign exchange risk: the rate of a currency may increase and cause the value of assets denominated in a different currency to decrease.

Interest rate risk: interest rate variations may lead to higher cost(s) or loss(es) of income for an investor.

Liquidity risk is the risk of the impossibility to sell a financial instrument at a certain price.

Inflation risk may occur when repayment is made in a depreciated currency or when an investor ends up with a rate of return below the rate of inflation.
Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing and operating a fund, offering fund securities are regulated activities under the General Regulations of the CREPMF and therefore subject to regulation by that organization and other organizations.

Collective Investment Schemes

Collective investment schemes include the following arrangements:

Undertakings for Collective Investment in Transferable Securities (UCITS) are financial institutions that collect savings from economic actors and issue stocks or shares. The savings thus collected are used to set up securities portfolios and to provide financing for businesses.

The activities under UCITS are classified collective asset management composed of two subcategories:

- Management for proper account: funds collected from third parties by the fund are invested in all types of securities and other financial products such as bonds, equities, negotiable debt securities and the like.
- Discretionary management: the fund is managed privately as the collective investment funds belong to third parties.

What are common fund structures?

Common fund structures include:

Collective investment funds under the forms of Undertaking for Collective Investment in Transferable Securities (UCITS) and Securitization Mutual Funds (Fonds Communs de Titrisation des Créances, FCTC (Instruction N° 46/2011 (Revised) Relating to the Classification and Allocation Rules Assets of Collective Investment Organizations on the Regional Financial Market of the WAMU).

UCITS take the form of:

- an open-ended, Investment Companies with Variable Capital, ICVCs (SICAV in French);
- mutual investment funds (Fond Commun de Placement, FCP) and any other collective investment vehicle approved by the Regional Council; or
- qualified investor structures that invest in products such as corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.
What are the differences between offering fund securities to professional/institutional or other investors?

Retail funds

Retail investors need more detailed information and advice to allow them to understand the investment documents and make sound financial decisions. Considered as laypersons, they benefit from enhanced protection.

Consequently, and based on those considerations, UCITS for instance, being one type of entity through which retail investments are made, are to be authorized by the CREPMF and are subject to considerable regulation.

Institutional/Professional funds

They are usually subject to less protective regulations.

Institutional and professional/Professional funds do have more expertise, are considered more experienced, sophisticated and able to understand and make sound financial and investment decisions.

There is, however, a legal and regulatory framework, in place, to secure subscribers based on the control mechanisms set up by the Central Depository/ Settlemcnt Bank (DCBR) and the CREPMF.

Are there any other notable risks or issues around establishing and investing in funds?

Investment management is a regulated activity and entities wishing to conduct such an activity are to be authorized by the CREPMF.

Risks and issues are of different types:

- **Currency or Foreign exchange risk:** investments in securities may be made in different currencies. The rates of currencies may change, and the value of a fund's investment be affected. Investments in a foreign market may entail exchange of currencies where an investor may have to exchange a domestic currency into a foreign currency, at an actual exchange rate, and convert it back into a domestic currency. Such conversion transactions may constitute risks that need to be mitigated.

- **Liquidity risk:** the risk of the impossibility to sell a financial instrument at a certain point of time.

- **Diversification risk:** investors may be exposed to risks when they invest in only one asset class or in a very limited number of assets. Such restrictive investments do not help in mitigating the risks inherent to the lack of diversification on such investments.

- **Solvency risk:** borrowers may be unable to meet their commitments and creditors may lose their claims.

- **Political risk:** this type of risk is associated with a political situation where authorities change their systems, such as the tax system(s), the ability to repatriate capital and the like.

Risks and issues are to be nuanced as there are substantial protections such as those provided for by the CREPMF acting as a regulatory agency entrusted with the protection of household savings invested in securities or any other type of investment through public offerings within the WAMU.

Further protection is provided, for instance, under Article 15.3 (Instruction N. 45 / 2011 of the CREPMF) and requires UCITS' assets be kept by a single depository, distinct from the UCITS management company.

National and Sub-Regional Legislations recognize the segregation of the Depositary's UCITS Clients' assets from the sub-custodian's own assets.

Those assets are, in some way, protected through entities like the deposit guarantee fund (Fonds de Garantie des Dépôts, the FGD-UMOA) in the WAMU.

The FGD-UMOA's mission is to provide deposit guarantees for customers of credit institutions and decentralized financial systems (DFS), approved in the WAMU.
Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Marketing is generally defined as the proposition to acquire investment products. Under the CREPMF and WAMU systems, it is, mostly, dealt with through the concept of solicitation.

Individuals intending to conduct public solicitation activities (business providers, direct sellers) are required to obtain a professional card issued by the Regional Council (General Regulation of the CREPMF, Article 108: The solicitation of the public).

Financial institutions, such as banks, wealth management companies, management and intermediation companies (SGI), business providers, individual or legal persons authorized for that purpose, are allowed, as of right, to have recourse to solicitation after reporting to the Regional Council (Article 155).

Solicitation of the WAMU's public by a non-resident entity, or on behalf of it, to propose the acquisition of investment products is subject to prior authorization of the Regional Council and the assent of BCEAO (General Regulation, Article 176).

Reverse solicitation is not specifically provided for under the applicable rules and regulations.

Prospective investors do, sometimes, make the first move, take the initiative to contact investors for potential acquisition of financial products. The financial entity needs to have evidence that the potential investor solicited them.

Are there any restrictions on managing a fund?

Fund management in the WAMU is mainly regulated under the General Regulations of the CREPMF and various implementing instruments.

The CREPMF regulate and authorize public offerings by granting approval. It monitors all private organizations acting on the market. For this purpose, it certifies all commercial stakeholders: brokerage firms, fund managers and individual entities (intermediaries and soliciting dealers).

The collective management of transferable securities is carried through UCITS, divided into open-ended investment companies (SICAV), Mutual Funds (FCP) or any other form of Undertaking for Collective Investment in transferable securities (UCITS) approved by the Regional Council.

Undertakings for Collective Investment in Transferable Securities.

UCITS' management is governed in accordance with the General Regulations of the CREPMF and Instructions 44, 45, and 46.

Mutual funds that hold more than XOF5 billion in assets are required to set up a system of controls and monitoring, such as a supervisory committee, an Internal Control reporting system and a reporting system for the FCP Custodian. The maximum assets that a Mutual Fund can hold is set at XOF25 billion. (Article 7 of Instruction N° 46/2011 (Revised) Relating to the Classification and Allocation Rules Assets of Collective Investment Organizations on the Regional Financial Market of the WAMU).

Any FCP which comes to hold assets in excess of XOF25 billion must declare it without delay to the Regional Council.

No FCP can hold, during six consecutive months, an asset greater than XOF25 billion, in which case the FCP must, within a six-month period, transform into a SICAV or proceed with a demerger.
Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

There is no specific legislation on derivatives. Provisions on derivatives can be found in different legal texts.

Certain restrictions do apply.

Businesses and entities proposing derivative contracts and products are to receive prior authorizations (from CREPMF and BCEAO).

The 2014 Uniform Act on commercial companies and Regulation 09/2010 contain some provisions on derivatives.

As per article 744 of that Uniform Act, public limited companies issue transferable securities whose form, class and characteristics shall be defined by the competent body of each state party.

Residents are authorized to conduct transactions on foreign exchange derivative markets through licensed intermediaries or foreign banks (article 12 of Regulation 09/2010).

Authorized transactions must be backed by trade or financial transactions, subject to compliance with all other regulatory provisions applying to the aforementioned transactions.

A limited number of commercial or financial transactions on derivatives can be conducted by residents.

They are authorized to carry out commodity derivative transactions on commodity futures markets (Article 13: Commodity derivatives).

They may use foreign exchange derivatives to hedge foreign-exchange risks, for the following commercial or financial transactions:

- imports and exports of goods and services by residents;
- foreign loan transactions by residents (draw-downs and payments); and
- direct foreign investments in a resident enterprise under negotiation.

Residents may use derivatives to hedge price risks. Those derivatives must be backed by commodity imports or exports carried out by the residents. They are not authorized to purchase commodities on foreign markets for delivery in commodity derivative transactions (Article 18).

What are common types of derivatives?

The main types of derivatives are:

- futures,
- forwards,
- options,
- swaps.

The value of the derivatives is derived from the value of an underlying asset or group of assets, the main classes of which are:

- Assets: commodities, shares or bonds;
- Interest rates, exchange rates, or indices;
- Foreign currencies.

Are there any other notable risks or issues around entering into derivatives contracts?
Market risk
Liquidity risk
Counterparty risk
Commodity price risk
Exchange rate risk
Interest rate risk

Risks are not that notable as the majority of the activities are conducted between sophisticated persons and are to a certain extent reserved for banks, and national and regional financial institutions which have a depository account with the Central Bank.

Residents are authorized to conduct transactions on foreign exchange derivative markets through licensed intermediaries or foreign banks (Article 12 of Regulation 09/2010).

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, a lender will need to be authorized by the BCEAO to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements. There are, however, some restrictions on lending. WAEMU residents who intend to borrow and invest abroad are required to get the prior authorization from the Minister of Finance.

They must be at least 75% financed through foreign loans. Foreign entities that wish to lend to WAEMU residents who want to invest abroad are required to finance those latter at a minimum percentage of 75% (Article 10: Investment transactions).

Financial institutions are required to comply with the rules governing the formation of the credit contract and to take into account the financial situation of the consumer when granting a credit. Specific legal rules for the credit agreement have been provided for such as ensuring the integrity of the consumer’s consent.

The granting of a credit is linked to the borrower’s ability to repay loan maturities on time. To achieve such a result, financial institutions have the obligation to take into account the borrower’s capacity to pay.

One example, in Labor Law, of determination of that capacity is specified under article 177 of the OHADA Uniform Act on simplified recovery procedures and means of execution which provides that the remuneration of natural persons employed or working in any capacity whatsoever, can be transferred or seized only in the proportions determined by each State Party.

The seized or voluntarily transferred amounts may not, under any circumstances, even for maintenance debts, exceed a threshold fixed by each State Party.

The transferable portion of the persons involved is set according to income and varies from one-third of the salary to half, particularly for home loans.

Borrowing

Yes, there are some restrictions on borrowing.

Regulation 09/2010, for example, provides one restriction pursuant to Article 10: Investment transactions, under which foreign
Investments made abroad by WAEMU residents are subject to prior authorization from the Minister of Finance. Moreover, they must be at least 75% financed through foreign loans.

Another restriction is provided under article 11 where loans contracted by residents from non-residents must, except by special decision of the Minister of Finance, be carried out through licensed intermediaries in all cases where the monies borrowed are made available to the borrower in the country. The licensed intermediaries thus called upon to intervene will ensure that the transactions comply with the applicable laws and regulations.

All foreign loans are subject to mandatory declaration to the External Finance Directorate and the BCEAO, for statistical purposes.


**What are common lending structures?**

Lending structures in Senegal depend on the parties' projects and needs.

Borrowers can be granted individual loans where one lender provides for the loan or syndicated loans where two or more lenders provide loans to one or more borrowers.

Syndicated loans involve large loans where the different participating banks share the risks as their liability is limited to the amount of their contribution.

Those syndicated loans are very complex transactions requiring the appointment of facility agents. Security agents are also appointed as provided for under Article 5 of the Uniform Act on Securities adopted on December 15, 2010.

Loans structuration depend on different parties' objectives. They can be commercial loans, concessional loans, non-concessional loans, equity loans, long term loans, short term loans, alternative forms of financing.

**Loan durations**

The duration of a loan can also vary between:

- a term loan, provided for a set period of time that usually lasts between one and ten years but can last a bit longer up to thirty years;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be withdrawn, repaid and redrawn if repaid; it provides for more flexibility and it can be reused as it is repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a bridge loan gives access to short-term loans that allow to meet short-term liquidity gaps or needs.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, refer to, among other texts, the Uniform Act on Securities.

**Loan commitment**

A loan can also be:

- committed, provides for terms and conditions imposed on the borrower and the lender is obliged to provide the loan if those terms and conditions are fulfilled; or
- uncommitted, meaning that the lender is not committed to provide the loan.

**Loan repayment**
The funds can be repaid on demand, in instalments, or scheduled to be repayable in full at maturity.

**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is characterized by less regulatory oversight and is less burdensome from a compliance perspective as institutional/professional borrowers are considered as more experienced and knowledgeable than other categories of borrowers.

Lending in the context of mortgages and to consumers is, by contrast, a more regulated activity and as such requires more protection and BCEAO authorizations. In Senegal, consumer credit is partly regulated through Law n° 2008-08 of January 25, 2008, on electronic transactions, Law n° 2008-11 of January 25, 2008, relating to Cybercrime and Decree n° 2008-718 of June 30, 2008, relating to electronic commerce which also deals with consumer law on a digital standpoint.

**Do the laws recognize the principles of agency and trusts?**

Senegalese laws do, specifically, recognize the principle of agency but not the principle of trust.

However, the Uniform Act on Securities recognizes the concept of Security Agent which may be considered as a corresponding concept to the security trustee.

The security agent is provided for under Article 5 of the Uniform Act on Securities which provides that “Any security or other guarantee to secure the discharge of an obligation may be made, registered, managed and executed by a financial institution or a national or foreign credit company acting in its own name and as surety agent appointed for that purpose by the creditor of the secured debt.”

A financial institution or a national or foreign credit company can act as a security agent.

**Are there any other notable risks or issues around lending?**

Yes, there are some risks and issues around lending.

Generally, contractual principles apply to loan agreements and other finance documents.

Those risks may be credit risks, default risks, interest rate risks which may be capped to a certain rate, percentage, exchange rate risks for cross-border transactions, security risk value.

**Specific types of lending**

Banks have access to other sources for their lending activities. They also provide loans in the real estate sector through the creation, in 2010, of the WAEMU Regional Mortgage Refinancing Fund (Caissé Régionale de Refinancement Hypothécaire de l’UEMOA) by the West African States Central Bank, the West African Development Bank (Banque Ouest Africaine de Développement (BOAD)) and the CREPMF.

Through that fund, they are able to access international capital markets and get resources for the funding of their mortgage activities.

One of its missions is to provide resources for the refinancing of mortgage loans to credit institutions in the WAEMU through the issuance of loans on the regional financial markets or through concessional financing from development partners.

Insurers in the WAEMU also invest in real estate, through pension funds, for long-term capital to the housing industry. The main Senegalese pension funds are: the Retirement Pension Fund (IPRES, Institution de Prévoyance Retraite du Sénégal) which covers private-sector employees, government employees who are not civil servants and local authority employees, the National Pension Fund (Fonds National de Retraite) which is for civil servants and members of the armed forces and the Social Security Fund.

**Standard form documentation**
Banks have their own standard form documentation that are used during bilateral finance transactions.

Cross-border financial transactions are sometimes based on the Loan Market Association standard documentation or on other standard forms.

**Are there any other notable risks or issues around borrowing?**

Missed payments can lead to risk defaults and collections processes which can have an impact on one's credit history or rating. It can also lead to difficulties in accessing to credit in the future. There is also a possibility of loss of property in case of default as collateral pledging can be very significant on the borrower's side.

**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**

There are some restrictions on key areas affecting the giving of guarantees and security.

**Capacity**

The capacity or power of a company to grant a guarantee or security is to be assessed on the basis of its constitutional documents. Such granting of guarantees and security have to be approved by a resolution of the company's board of Directors.

**Insolvency**

Guarantees and securities may be declared void in situations provided for under the Uniform Acts.

Acts done by the debtor during the suspicion period from the date of suspension of payments to the date of the decision to open proceedings shall, as of right, be non-binding or may be declared non-binding on the body of creditors as defined under Article 72 of the Uniform Act on Collective Proceedings for Debt Clearance.

The following shall, as of right, be non-binding on the body of creditors if and when they are done during the suspicion period: any conventional mortgage or conventional pledge, any constitution of pledge granted on the debtor's property for debts previously contracted, any provisional registration of a conservatory judicial mortgage or a conservative judicial pledge.

**Financial assistance**

A company is, in principle, prohibited from purchasing its own shares. Managers are prohibited from contracting, under any form whatsoever, loans from the company, obtaining an overdraft on a current account or otherwise from the company or make the company endorse or guarantee their commitments towards third parties.

This prohibition shall also apply to spouses, ascendants and descendants of the persons referred to above, including any intermediary through whom these persons act.

**What are common types of guarantees and security?**

**Common forms of guarantees**

Under OHADA, personal securities are surety bond and autonomous guarantee and counter guarantee.
Surety bond: A surety-bond shall be a contract whereby the surety undertakes, and the creditor accepts, to discharge an existing or future debt contracted by the debtor in the event of the latter failing to do so.

Autonomous guarantee and counter guarantee:

An autonomous guarantee shall mean an agreement by which, the guarantor undertakes, following an obligation signed by the principal and on its instructions, to pay a fixed sum of money to a beneficiary either at the earliest demand of the latter or as per the agreed terms.

The autonomous counter guarantee shall mean the agreement by which the counter guarantor undertakes, following an obligation signed by the principal and on its instructions, to pay a fixed sum of money to a guarantor either at the earliest demand of the latter or as per the agreed terms.

Transferable securities consist of possessory lien, assets held or transferred as security, pledge of real property, pledge of intangible assets and privileges.

**Common forms of security**

- Pledge
- Liens
- Mortgage

Different types of security are suitable for securing different types of assets.

Under Senegalese Law it is possible to grant security over all of a company's assets or on individual assets. Granting security over all of a company's assets will tend to be achieved by way of a debenture which will include:

- a mortgage over real estate; and
- a pledge over movable goods.

Moreover, guarantees and security, to be enforceable as against third parties need to be perfected and registered.

Are there any other notable risks or issues around giving and taking guarantees and security?

To be valid, a guarantee needs to be in writing and contain some mandatory elements:

General contractual principles apply to consideration for a guarantee.

The underlying obligations will usually be the consideration for the guarantee and the execution of the underlying obligations, and the guarantee should be concomitant to avoid a possible qualification of past consideration.

There should generally be no issue as in the majority of cases. The guarantee is provided for in an underlying document as in the case of a loan agreement.

A guarantee may be set aside for different reasons and a beneficiary of a guarantee should take those into account and avoid them.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in
**finance and investments generally?**

**Generally**

Investment activities/services:

Investment activities/services in Senegal are mainly regulated by the following Laws and Regulations:

- The General Regulations of the Regional Council for Public Savings and Financial Markets (Règlement Général du Conseil régional de l'épargne publique et des marchés financiers, CREPMF) (General rules of the CREPMF);
- The General rules of the Regional Stock Exchange (Bourse Régionale Des Valeurs Mobilières, BRVM);
- Law on fixed capital investment companies in the WAEMU 2003 (Loi relative aux entreprises d'investissement à capital fixe dans l'UEMOA);
- Framework Law on Banking Regulations of the WAMU, December 3, 2010; Regulation No. 09/2010/CM/UEMOA on External Financial Relations of the Member States of the West African Economic and Monetary Union (WAEMU); and

**Consumer credit, Corporations, Mortgages, Funds and platforms**

- Consumer Law No. 2016-412 of June 15, 2016;
- WAEMU;
- Decision No. 397/12/2010 Issuing Regulations, Tools and Procedures to Implement the BCEAO Monetary and Credit Policy (consumer protection-related) (2010);
- Decision No. 397/12/2010 Issuing Regulations, Tools and Procedures to Implement the BCEAO Monetary and Credit Policy – Title III Excerpt (enacted in 2010) (English)

**Corporations**

- Ohada Uniform Act relating to General Commercial Law adopted on December 15, 2010;
- Revised Uniform Act on commercial companies and economic interest groups (the Revised Uniform Act), adopted on January 30, 2014.

**Mortgages**

- Uniform Act Organizing Securities of December 15. 2010

**Funds and platforms**

- Regulation No. 02/2010 / CM / UEMOA relating to securitization of mutual funds and securitization transactions in the WAEMU (Règlement n° 02/2010/CM/UEMOA relatif aux Fonds communs de titrisation de créance et aux opérations de titrisation dans l'UEMOA);
- Instructions 44, 45, and 46 of CREPMF and regulation on the organization and functioning of the financial market of the WAEMU;
- Regulation No. 03/2010 / CM / UEMOA relating to covered bonds in the WAEMU.
Other key market legislation credit

- Regulation n° 06/2013 / CM / UEMOA of June 28, 2013, on Treasury bills and bonds issued by auction or syndication with the assistance of the WAMU Securities Agency (Agence UMOA-Titres);
- Decision No CM / SJ / 001 / 03/2016 Relating to the Implementation of the Monetary Penalties Mechanisms Applicable on the Regional Financial Market of the WAMU;
- Regional financial markets Instruction 2011;
- Uniform Act on simplified recovery procedures and measures of execution;
- WAEMU Instruction governing activities of electronic money issuers 2015;

Regulatory authorization

Who are the regulators?

The Financial Market Authority is the Regional Council for Public Savings and Financial Markets (CREPMF). It regulates the functioning of the market and authorizes public offering procedures by granting visas.

It enacts rules and regulations on the regional stock market, market access conditions, publicity rules and information of the public.

It has the power to control the different stakeholders operating in the regional market.

The Regional Stock Exchange (BRVM) is responsible for organizing the stock market, ensuring the listing and trading of securities, ensuring the dissemination of stock market prices and information, promoting and developing the market.

The Central Bank of the West African States (BCEAO) issues currency, manages monetary policies, organizes and monitors banking activities in general.

The WAMU Securities Agency (Agence UMOA Titres) assists states, through the regional and international capital markets, in raising their resources needed to finance and fund their economic development through the identification of the most suitable means.

What are the authorization requirements and process?

The main authorization requirements are obtaining an approval and/or a visa depending on the type of entity or individual. Under the General rules of the CREPMF, some investment activities require an approval (agrément) from the CREPMF and others require authorization from both the CREPMF and BCEAO (Regulation 09/2010).

In accordance with the applicable laws, rules and regulations, the conduct of the following activities on the regional financial market, without this list being exhaustive, is subject to the approval or authorization of the Regional Council: securities trading, maintaining securities accounts, reception and transmission of orders, presentation of daily buy and sell offers, asset management mandates, financial marketing or solicitation, collective asset management, debt securitization (titrisation des créances), financial rating, financial transaction guarantee (Garantie des opérations financières),

Once applications are received, they are assessed within a one- to three-month period from the date of filing of the application.

The application fee depends on the type of entity and the nature of the activity, ranging from XOF500,000 to XOF50 million.

The application process will end up with an individual decision by the Regional Council (CREPMF).

A list of authorized entities and individuals can be found with the CREPMF and the Regional Stock Exchange (BRVM).
What are the main ongoing compliance requirements?

Approved or authorized entities have continuous obligations such as sufficient guarantees, in particular with regard to the composition and amount of their capital, their organization, their human, technical and financial resources, the integrity and experience of their managers, as well as their own measures to ensure the security of clients' transactions.

They must undertake, in writing, that any modifications made to their Articles of Association during the course of their existence are subject to the prior authorization of the Regional Council when they relate to a distribution of capital between shareholders, a change in the scope or nature of the guarantees submitted, a change in the accounting methods and information used, or any other modification to the Articles of Association, the Regional Council must be informed.

In case of failure of those entities to comply with key requirements, the Regional Council can take steps to restore compliance with the rules. If violations continue, it can decide on the sanctions to be taken, in accordance with the provisions of the General Regulations, in particular the suspension of all or part of their activities.

What are the penalties for failure to be authorized?

A person, be it a natural or legal person, undertaking a regulated activity without being approved, authorized or exempted is liable to a certain number of sanctions.

Failures are classified into four categories and subject to a range of financial penalties.

The penalties apply to any stakeholder in the regional financial market as well as to any natural or legal person responsible for non-compliance.

Failure, for instance, to obtain the prior visa by the Regional Council results in the nullity of transactions, both with regard to the applicant and the solicited public. In addition, issuers are liable to sanctions from the Regional Council, without prejudice to legal proceedings (Article 115 of the General Regulation of the CREPMF).

Regulated activities

What finance and investment activities require authorization?

Generally

Combined provisions of the General Rules of the CREPMF and the Regulation 09/2010 provide for the financial and investment activities that require authorization.

Under the General rules of the CREPMF, the following activities qualify as investment activities that require an approval (agrément):

- issuing and distributing securities; trading and intermediation on the securities market;
- trading and intermediation on the derivatives market;
- organization and operation of stock exchanges;
- organization and operation of commodities and futures exchanges;
- management of securities portfolios and custody of securities; and
- provision of investment advice.

Moreover, pursuant to article 8 of Regulation 09/2010, the following activities require an authorization from CREPMF and BCEAO:

- the issue, exposure, sale of securities of foreign states, public authorities or foreign companies and international institutions;
the solicitation of residents with the aim of constituting deposit funds with foreign private individuals and offshore establishments; and any publicity or marketing, edited on the territory of a WAEMU Member State with the aim of investing offshore funds or subscribing to operations related to offshore real estate constructions.

**Consumer credit**

Consumer credit activities, including hire-purchase and rental with option purchase, discount, reverse repurchase, acquisition of receivables, guarantees, purchase financing, leasing and service delivery are regulated activities.

Furthermore, these activities can only be offered by firms who are authorized and listed on the financial services register.

_Last modified 29 Jul 2020_

**Are there any possible exemptions?**

Transfers of securities listed on the Regional Stock Exchange are made through an SGI, except in the case of an exemption granted by the Regional Stock Exchange (Article 37 of the General Regulation of the CREPMF).

The provision of investment advice, in particular of a stock market nature, as a usual profession to third parties, is subject to prior authorization from the Regional Council (Article 95 of the General Regulation of the CREPMF).

However, SGIs and banking institutions are authorized to exercise the activity of stock market investment advice by way of derogation from the preceding article (Article 96).

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**Do any exchange controls or other restrictions on payments apply?**

Payment transfers are, in principle, free. However, some exchange controls and other restrictions on payments apply.

Under article 2 of Regulation n°09/2010/CM/UEMOA, foreign exchange transactions, capital movements (issuance of transfers and/or receipt of funds) and settlements of all kinds from a WAMU Member State to a foreign country or in the WAMU space between residents and non-residents can only be made through the BCEAO, the Administration or the Post Office, a licensed intermediary or a licensed manual exchange agent.

Licensed intermediaries are allowed to perform the following activities to a destination abroad, under their responsibility and on the basis of supporting documents (art. 7 of the Regulation n°09/2010/CM/UEMOA):

- the transfer of money required for contractual debts amortization as well as short-term repayment of loans granted for the financing of commercial and industrial operations;
- the transfer of the liquidation of investment proceeds or the sale of foreign securities by non-residents; and
- the required settlements, either for transactions on derivative instruments or for transactions on commodity derivatives and basic products.

Payments to foreign destinations in respect of capital transactions, other than those provided above, must be done based on an application for foreign exchange authorization submitted to the Minister of Finance.

_Last modified 29 Jul 2020_

**What are the rules around financial promotions?**

A financial promotion is a proposition for the acquisition of investment products. It is, mostly, dealt with under the concept of solicitation.

Individuals intending to conduct public solicitation activities (business providers, direct sellers) are required to obtain a professional card issued by the Regional Council (General Regulation of the CREPMF, Article 108: The solicitation of the public).
Financial institutions, such as banks, Wealth Management Companies, Management and Intermediation Companies (SGI), business providers, individual or legal persons authorized for that purpose, are allowed to have recourse to solicitation after reporting to the Regional Council (Article 155).

Solicitation of the WAMU's public by a non-resident entity, or on behalf of it, to propose the acquisition of investment products is subject to prior authorization of the Regional Council and the assent of BCEAO (General Regulation, Article 176).

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

The types of legal entity that are generally used to undertake financial or investment activity are limited companies, they can be private law companies incorporated as a public limited company.

That type of entity is used for the Regional stock exchange (BRVM) and the Central Depository/Settlement Bank under Article 12 of the General Regulation, where they are specifically characterized as “private law companies incorporated as a public limited company.”

Management and intermediation companies are to be established as Public Limited Companies (Société Anonyme, Article 30).

Funds such as open-ended investment companies (SICAV) are also to be established as Public Limited Companies (Instruction N ° 21/99 Relating to the Classification of UCITS, Article 2).

The types of legal entity that are generally used to undertake financial or investment activity are a Public Limited Company, PLC (Société Anonyme SA), Limited Liability Company (SARL) and a Simplified Public Limited Company (Société par Actions Simplifiées SAS).

Simplified Public Limited Companies (SAS) started being used as a legal entity to undertake financial or investment activity with the 2014 Revised Uniform Act due to their flexibility compared to SAs, for instance.

The AUSCGIE provides for company forms which can be with variable capital, to know PLCs not calling for public capital and Simplified Public Limited Companies (SAS).

Funds

Investment funds can take the following forms. An open-ended investment company (SICAV) is to be established as a Public Limited Company (Instruction N ° 21/99 Relating to the Classification of UCITS, Article 2).

Fixed capital investment companies are provided for under the 2003 Law on fixed capital investment companies in the WAEMU (Loi relative aux entreprises d'investissement à capital fixe dans l'UEMOA). That Law has been transposed, internally, in Senegal under the Uniform Law on fixed capital investment companies (Loi uniforme n° 2007/15 du février 19, 2007, relative aux entreprises d'investissement à capital fixe).

The Uniform Law requires investment firms to obtain prior authorization from the supervisory authority, CREPMF, while international practice has evolved towards prior authorization of fund managers rather than of the funds themselves.

Is it possible to conduct lending or investment business through a branch or establishment?

It is possible to conduct lending or investment business through a branch or establishment in Senegal. Such a possibility is, however, subject to restrictions.

The branch shall not have a separate legal personality distinct from that of the parent company or the natural person who owns it (Article 117 of the AUSCGIE).
The branch may be an establishment of a foreign company or natural person.

Subject to international agreements or laws to the contrary, the branch shall be governed by the law of the State Party in which it is located. (Article 118). It shall be registered in the Trade and Personal Property Rights Register in accordance with the provisions organizing said register.

Where the branch is owned by an entity, it shall be attached to a company in existence or to be created, governed by the laws of one of the State Parties not later than two years after the branch is set up, unless this obligation is waived by order of the minister in charge of trade in the State Party in which the branch is located. (Article 120).

**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

The most common technology products and fintech applications used or being developed in the finance and investment marketplace are:

**Peer-to-peer funding platforms and marketplace lending**

A salient feature of marketplace lending is a wide variety of market participants and financing mechanisms.

The principal characteristics of new marketplace lenders one can name are:

- the recourse to non-bank lending platforms established as specialist corporate or special purpose vehicle (SPV) based structures;
- the use of technology to leverage and optimize the lending platforms; and
- matching borrowers to lenders, through platforms rather than using the traditional financing mechanisms.

Marketplace lending is available to address most forms of traditional bank funding products. Recent products have included:

- consumer loans;
- prepaid cards;
- residential property and commercial property lending; and
- small and medium-sized enterprises (SME) lending.

**How are marketplace lending platforms funding themselves?**

A large number of people contribute small amounts of money, in order to fund projects. That money raising is usually organized via the internet, through platforms.

There is a significant potential for peer-to-peer (p2p) lending in microfinance in Senegal. Recourse to those platforms has been increasing over the years. Eligibility for that type of financing structure is, sometimes, characterized by an absence of intermediaries and based on an assessment of entrepreneurs’ credit history, their ability and capacity to pay back their loans that banks and financial institutions have granted them in the past.

This is the case with Zidisha.org, an online microlending community that directly connects lenders and entrepreneurs.

**Blockchain, smart contracts and cryptocurrencies**

Blockchain, smart contracts and cryptocurrencies are not regulated, neither under WAEMU nor in Senegal.
The Central Bank (BCEAO) did not hide their negative position as far as cryptocurrencies are concerned. Their approach stems from a series of concerns especially in terms of protection of personal data, compliance with competition rules, national security and monetary policy. They have reiterated their concerns during a Facebook project to create a cryptocurrency called Libra under the following terms: “This cryptocurrency project is the source of many concerns among regulators, particularly in terms of protection of personal data, compliance with competition rules, national security and monetary policy,” said the Central Bank’s representatives in their monitoring report for financial services backed by electronic payment.

Money creation is strictly controlled by the central authority, which issues and destroys it.

It is in the same line of thoughts that members of the CREPMF have, many a time, referenced the regulations. On the money market, only a bank can hold an authorization and provide a financial guarantee from the BCEAO to be able to collect money from the public against the payment of interest.

The situation is not different in the financial market, where only an SGI has the same authorization from CREPMF.

**Initial coin offerings and token-based products**

Initial coin offerings and token-based products have not yet been subject to rules and regulations within the WAEMU. Their use is not tolerated in the WAEMU zone. Senegal, being part of the eight WAMU member countries, has not, at least for now, allowed the creation or use of digital currency.

Money creation is strictly under the power and control of a central authority, BCEAO.

Please refer to response above, on blockchain, smart contracts and cryptocurrencies under (Topic 13).

**Artificial intelligence and robot advisory systems**

Artificial intelligence and robot advisory systems are not specifically regulated in the WAEMU or in Senegal.

However, as a tool using telecommunications, it is also subject to the provisions contained in the Senegalese telecommunication code. In Senegal, telecommunication activities are controlled by the regulatory authority, which is the Telecommunications and Postal Regulatory Authority (ARTP).

Such an activity is not regulated; however, its use is being promoted within the WAEMU zone, including among young people through competitions as was the case of those organized under the auspices of the regional stock exchange, the BRVM Fintech Innovation challenge, the first edition of which was launched from September 18, 2018, to October 17, 2018.

There was no Senegalese recipient and the Ivorian recipient, Mr. Cédric Arthur Yao, presented “the Fetish project,” an application dedicated to technical analysis on the stock market.

The aim of the proposed analysis model was to allow a short-, medium- and long-term investment orientation for securities and to anticipate possible price rises and falls. The intention of the Fetish application was to integrate this technical analysis model into a digital application.

**Data analysis and cloud computing**

Cloud services are at their early stage in Senegal. They are used by banks for investments to improve customer experience and credit risks. Governments are also using them to provide certain public services.

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

The Regional council for public savings and financial market (CREPMF) is the regulator for the provision of financial products and services.

**General**
The conduct of regulated financial activities requires prior authorizations, approvals, generally, from the CREPMF and the BCEAO.

Some restrictions, specific laws, regulations and procedures may apply to fintech products.

Entities providing fintech products and services with regulated financial activity components are required to be authorized and comply with different laws, rules and regulations such as data protection and consumer protection Laws.

**Electronic payments platforms and regulation of peer-to-peer lenders**

Electronic payments platforms are governed through BCEAO Instructions, mainly Instruction N° 008-05-2015 governing the terms and conditions for the exercise of the activities of issuers of electronic money in the member states of the West African Monetary Union (WAMU).

E-money transactions done through cards, internet and telephone are regulated under said Instruction.

The definition of e-money has been made taking into account “good international practice” and is characterized by a monetary value electronically stored, issued against funds provided in at least an equal amount and that has been accepted as a means of payment by both individual and corporate third parties.

Banks, payment services companies and microfinance institutions (MFIs) are allowed to issue e-money and can conduct e-money transactions.

Banks and payment services companies holding existing BCEAO licenses along with e-money authorizations, as FI issuers, must notify BCEAO (two months) in advance of any deployment, while microfinance institutions (MFIs) must get prior authorization from the Minister of Finances following consent from BCEAO.

Nonfinancial entities may also issue e-money after obtaining a license. These issuers are called *Etablissements de Monnaie Electronique* (EMEs or non-FI issuers). They must meet separate standards on corporate governance and related matters to obtain a license. These EME companies must be solely dedicated to e-money issuance, (i.e. providing payment, transfer, and cash-in/out services). They cannot provide savings or credit services. EMEs can own shares only in other entities involved in e-money issuance.

**Peer-to-peer lenders**

It is important to mention that there is no specific regulation on this matter.

However, the need to regulate this type of product in order to protect consumers has been noted in some countries. The Regional Council and BCEAO are conducting reflections in this direction, in order to propose protection mechanisms for consumers.

**Regulation of payment services**

Entities intending to exercise payment services are required to be duly approved or authorized, beforehand, by the Central bank. Banks and financial payment institutions, authorized by laws regulating banking, are allowed to conduct transactions related to payment services.

However, they are required to inform BCEAO, at least two months before the start of their electronic money issuance activities or the marketing to the general public, of any new money-related electronic service.

Electronic money institutions must be approved by the Central Bank before starting their electronic money issuing activities.

The exercise, by decentralized financial systems, of activities linked to electronic money, is subject to the prior authorization of BCEAO. (Article 8 of the Instruction).

Electronic money institutions must have a specific legal form and corporate purpose. They must be constituted in the form of Joint Stock Companies or Companies with Limited Pluripersonal Liability, Mutuals, Cooperatives or Economic interest Groups.

With the exception of banks, financial payment institutions and decentralized financial systems, the issuance of electronic money can only be carried out by a legal person whose corporate object relates exclusively to this activity.

Diverse forms of electronic payment are available in Senegal. These include the use of credit and debit cards, mobile phones, online payment services such as Paypal, Alipay or Apple using the iTunes card, bank transfers and payment upon delivery.
Application of data protection and consumer laws

Data Protection in Senegal is regulated under Law No. 2008-12 on the protection of personal data. The Law provides for the collection, registration, processing, storage and transmission of personal data. An independent authority, the Commission of Personal Data (CDP) was established to ensure that personal data related activities are done in accordance and compliance with the Law.

Senegal ratified the convention on Cyber Security and Personal Data Protection adopted by the African Union in 2014. In addition to this text, the "Strategy Senegal Digital 2025" was launched in 2016 with the ambition to achieve emergence through digital technology, strategy the cost of which is estimated at XOF1,361 billion mainly allocated as follows: 73% for the private sector, 17%, for the public sector.

To fill in the gaps partly caused by an increased digitalization and update the legislation on the technology and telecommunications sectors, a bill has been circulated in 2019 for comments and recommendations.

The transfer of personal data to third countries are allowed subject to sufficient protection guarantees.

Sensitive data collection, processing and related activities are subject to prior authorization from the CDP).

The 2008 Law on electronic transactions regulates, among others, direct solicitation marketing by electronic means. It provides for commercial solicitations by prohibiting unsolicited advertising by electronic message, without having obtained prior consent from recipients.

The General Regulation of the CREPMF also regulates solicitation of the WAMU public under Article 176 of the General Regulation of the CREPMF.

Money laundering regulations

An anti-money laundering/countering the financing of terrorism (AML/CFT) framework is used by member states of the West African Economic and Monetary Union (WAEMU). Senegal was the first country to implement it, domestically, through the adoption of a terrorist financing law, Uniform Law n° 2009-16 of March 2, 2009, relating to the fight against the financing of terrorism.

A 2015 WAEMU directive provides for safeguards for the financial sector.

Involved entities include banks, MFIs, e-money issuers, payments and transfers companies, commercial and consumer credit providers, insurance providers and agents that provide financial services.

Know your customer (KYC) procedures are specified in the directive and before any transaction, all involved entities must identify their clients – both individuals and organizations by obtaining the client's full name, place and date of birth, primary address and verifying these by checking a valid “official document” with a photograph (to be copied) and documentary proof of address.

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2015 give the National Financial Intelligence Processing Unit CENTIF responsibility for supervising the anti-money laundering control of businesses that offer certain services, such as lending, provision of payment services, issuance and administration of other means of payment.

Generally, where a firm is authorized and supervised by the CENTIF, it will also be authorized and supervised by the CENTIF as far as compliance with anti-money laundering requirements is concerned. Electronic currencies and other cryptocurrencies tend to represent a higher money-laundering risk.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

Seed investment

Alternative financing mechanisms are needed and sought as startups are having difficulties accessing to financing.
Among potential alternatives were the recourse to angel investments and crowdfunding initiatives. Angel investments have been promoted by entities like NGOs such as Enablis. Foreign business angels, especially French ones, provided some fintech businesses with initial investments.

For illustrative purposes, a tech community, composed of some 15 startups, Teranga Tech, participate in strengthening digital growth in Senegal, by encouraging skills transfer, partnerships and job-creating investments that will benefit the Senegalese economy. The community will support projects in fields such as agriculture (agritech), education (edtech), health technologies (medtech), biotechnologies (biotech), finance (fintech) and cultural and creative industries (CCI).

One of the main objectives of the community is to provide technical and financial support aimed at developing innovative entrepreneurship integrating decentralized project leaders.

Investments for small projects, with financing needs ranging between USD10,000 and USD50,000 are scarce and need to be developed.

**Crowdfunding**

The crowdfunding sector is at its early stage in Senegal. Crowdfunding platforms have been launched bringing together individuals, entities and charities to finance personal and charitable projects.

Crowdfunding has also been seen as a possible alternative through which foreign aid may be sent in order to resolve issues such as corruption. However, legal and regulatory obstacles have slowed that initiative that has been considered by foreign countries such as the UK.

An example of a crowdfunding finance project, is “Peeling of the Onions of Senegal.”

The STARS program (Strengthening African Rural Smallholders), in partnership with the Mastercard Foundation, assists 8,000 onion smallholders to develop marketing tools and financial products and attain a certain level of productivity and food security which will, at the end, support Senegal to become self-sufficient in onion production in the near future.

BaySeddo is a (digital) platform reuniting producer organizations and individuals looking to invest in short-term agricultural projects. The farmers’ lands, representing resources for exploitation from investors, will be added in the hope to achieve win-win results.

BaySeddo is expected to initiate similar projects with other producer organizations participating in STARS program.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. It provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a fintech startup is that the fund is able to share its knowledge and expertise of the fintech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), secured against a company's assets and including an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

Entrepreneur and Director, Mrs. Caty Lo, having a rice trade and processing business activity with an annual turnover of EUR750,000 and a staff of 20, considered EUR300,000 offered by Venture capitalists, insufficient and intends to try to find financing elsewhere without having those venture capitalists to become shareholders in her business.

For the financing of her business, she also admitted that she has been able to finance investment of EUR150,000 for her own factory with own money and credit from family members.

**Senior bank debt and capital markets funding**

Once a fintech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the
facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

Incentives and reliefs

The investment code is intended to help investors with their potential projects in Senegal. Indeed, international investors are urged to rely on local companies in the conduct of their operations in order to benefit from certain incentives offered by the legal system.

The objective is, of course, to open up opportunities for SMEs and to give an inclusive character to Senegalese economic growth. Thus, large foreign companies eligible for the benefits of the Investment Code are entitled to tax credits provided that they apply a local content policy on job creation, opening of social capital to nationals and the outsourcing.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Loans are commonly bought and sold.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio.

The most common ways of selling loans are:

- Novation – a transfer of title of a party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a new contract between the continuing party and the transferee and the transferor being released from its obligations.
- Assignment – a transfer of rights only and not of obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. An assignment can be effected as either an equitable assignment or as a legal assignment.

The Loan Market Association documentation is sometimes used for loan transfers.

What are the main considerations when transferring a loan and related security?

Loans contracted by residents from non-residents must, except by special decision of the Minister of Finance, be carried out through licensed intermediaries in all cases where the monies borrowed are made available to the borrower in the country. The licensed intermediaries thus called upon to intervene will ensure that the transactions comply with the applicable Laws and Regulations.

All foreign loans are subject to mandatory declaration to the External Finance Directorate and the BCEAO, for statistical purposes. The repayment of any foreign loan, either by purchase and transfer of foreign currencies or by crediting foreign accounts in Francs or in Euros, must be declared for statistical purposes to the External Finance Directorate and the BCEAO and said transactions must be carried out through a licensed intermediary.

Before transferring a loan, a number of issues, below, must be taken into account:

- Confidentiality: whether disclosure of information relating to the loan is allowed, to a potential transferee for instance.
- Data protection: whether there is any personal or restricted data or information in the loan that should not be disclosed.
- Lender eligibility: whether there are any restrictions on potential transferee entities.
- Undrawn commitment: whether the transferee will be subject to continuing obligations for further funding or reduction of claims.
Transfer mechanics: whether there are any procedures to be followed for the transfer.

Consent: whether the consent or notification of any other parties is required for the transfer.

Projects

Financing / investing in energy / infrastructure

*To what extent are energy and infrastructure assets publicly or privately owned?*

Generally

Ownership of energy assets and infrastructure in Senegal varies according to the asset class. The key sectors are discussed below.

Energy:

**ELECTRICITY**

Senegal is facing problems as the demand for electricity grows faster than its supply. SENELEC, the national electricity company, is far from getting the needed financial resources to invest in powerplants and transmission lines and fill the gap left by an increasing imbalance between the demand and supply for electricity.

The energy sector is managed by and is under the control of the National Electricity Company of Senegal (SENELEC), a state company which deals with the management of state-owned sector assets and ensures the financial equilibrium of the sector.

The Senegalese electricity sector is reorganized under three entities: the national utility company (SENELEC), the Agency for Rural Electrification (L’Agence Sénégalaise d’Electrification Rurale, ASER) and the Electricity Regulatory Board (Commission de Régulation au Secteur de l’Electricité, CRSE).

To settle the low rate of the rural electrification problem, the Senegalese government came up with the Rural Electrification Action Plan (PASER) where the country was divided into ten concessions, six of which were allocated to private sector companies with the monopoly for electricity distribution within their concessions.

Unfortunately, they have encountered tremendous hardship. The remaining four concessions were awarded to SENELEC which remains the major electricity service provider in rural areas, covering 96% of clients.

**GAS**

The gas industry in Senegal is privatized. A number of private sector companies provide production, transportation and distribution services. The private sector companies involved, which own the generation, transmission and distribution assets, are in particular, Kosmos Energy and British supermajor BP, both of which are partnering through a joint-operating venture.

While ECOWAS representatives called for Member States to develop policies on the popularization of Liquified Petroleum Gas (LPG) and to promote access to modern energy and cooking fuels, the West African Monetary Union (WAMU) encourages and recommends poorer households to return to their traditional fuel usage patterns warning that if subsidies for LPG are not granted or are not sufficient, demand for charcoal may continue to increase leading to more deforestation which leads to annual forest-losses of 0.5%.

A minimum target penetration rate of 30% by 2030 is expected to be attained with an emphasis on rural communities’ access to LPG.

A recommendation has been made to put in place a regional strategy with a proposed implementation timeline of 2019-2030 that will promote and accelerate people’s access to LPG which is a cleaner source of energy than biomass.

**Telecom Infrastructure**

The Senegalese Telecommunications Regulatory Authority (ARTP) is the regulator of the telecommunications sector in Senegal. It is also
Telecommunication networks (fixed and mobile) is characterized by private ownership. The main company providing a number of services in the sector is Orange Senegal. The opening of the market has brought two other global operators: Free and Expresso.

Around USD910 million is spent on infrastructure, per year.

The country is said to have an excellent telecommunications infrastructure and a connection to more than 40 countries around the world. Services such as cable, telex, fax, and internet are available and there has been an increasing demand for internet-related services and cellphone usage.

A remarkable growth of mobile telephone use was reported, from 1.5 million subscribers in 2005 to 15.3 million in 2016, when mobile penetration reached about 117% by mid-2016.

**Aviation**

Access to financing in the aviation sector is difficult to obtain and may be quite costly when available. Financing from commercial banks are hard to get including for aircraft acquisition.

Guarantees from the government are, at times, sought and granted with little reticence encountered on the part of the Senegalese government.

Aviation leasing is quasi inexistent on the continent and costly when available in foreign markets.

However, financing through Export Credit Agencies (ECAs) have become a source of financing as was the case for the acquisition of Airbuses by Air Senegal.

**Are there special rules for investing in energy and infrastructure?**

**Generally**

There is no specific regime governing or restricting investment in energy or infrastructure projects in Senegal, in addition to existing regulation for investors. However, a particular proposed investment may be subject to legislative or regulatory control (e.g. merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory context relevant to that project must be considered. For example, a project involving development on land will require, among others, planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector-specific regulatory consents or licenses. Where a public entity (e.g. a government department or a local authority) is procuring a project using private finance, and that entity is to benefit from central government funding, the project will be subject to central government approval.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public-sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on Change of Control. This is less of a concern on private sector infrastructure, although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

**Energy**

**ELECTRICITY**

In 1998, the Law on the electricity sector liberalized the energy sector and brought new perspectives for private-sector investment in electricity generation. It was amended in 2002 to introduce greater transparency to the private sector tenders procedures.

The electricity industry is managed by SENELEC, which is the state-owned company, responsible for the distribution of electricity. There are, however, independent power producers such as GTI-Dakar and ESKOM-Manantali.

The regulator of the energy sector is the Electricity Regulatory Board (CRSE), an independent authority created by Law 98-29 of April 14, 1998, relating to the electricity sector and responsible for the regulation of the production, transport, distribution and sale of electric...
energy in Senegal. It approves revenue requirements and licensing for the sector and leads IPP tender processes. It monitors compliance with regulations, manages disputes between industry players, ensures the protection of consumers’ interests and issues opinions on operating licenses and regulatory texts.

SENELEC has a monopoly on transportation across the country, with the exception of the interconnected Manantali hydroelectric dam. The company operates a number of production units (416MW of installed capacity in 2007) and is bound, by contracts, to purchase electricity from independent power producers (IPPs) for a period of 15 years (GTI 1, Manantali 2 and from some Senegalese self-producing industries, totaling about 150MW of additional installed capacity). In addition, SENELEC is under obligation to deploy renewable energy within its concession areas.

Power generation is currently reliant to a significant degree on independent power producers (IPPs).

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What is the applicable procurement process?

Different procurement procedures are provided for when purchasing goods and services in Senegal.

An invitation to bid can be opened or restricted.

A contract is awarded without negotiation, after competitive tender, to a bidder which has fulfilled the conditions of the bid and has submitted the lowest bid price.

The open bid process, which is the default procurement process, allow tenderers to submit offers. The tender period is, in principle, set at 30 days for national invitations to tender and 45 days for international invitations to tender, which may be reduced to 10 and 15 days respectively in urgency situations.

Under the restrictive process, bidders are invited to bid; however, this process has not often been used since 2014.

The Direct agreement is permitted to be used in cases of extreme urgency for public service continuity considerations or where only one supplier or service provider is able to provide the requested good, service or work. The authorization of the Central Directorate for Public Procurement (DCMP) is however required for a direct agreement. This procedure is, in practice, mostly used when a government wants to expedite a process for strategic or political purposes. It is often used for large projects.

The Request for Quotation (RFQ): Under this procedure, quotations are requested from at least three suppliers. The procedure is not frequently used, it is mainly for services or products immediately available and, sometimes, for small construction contracts (often less than XOF30 million).

This mechanism is said to be a source of corruption and procurement abuse as the type of contracts involved may be subject to less scrutiny compared to larger contracts.

The Request for proposal (RFP): is a two-stage procedure where a request for proposals is sent to at least the first three candidates selected through a call for expression of interest (EOI). They receive the reference terms and a letter of invitation specifying the selection criteria and information on the application as well as the draft contract. If the estimated amount of the contract falls below the thresholds set out in Article 53 of the Code, the process does not need to be public and five providers may be invited to submit a proposal.

Financing energy and infrastructure

Public procurement in Senegal is based on three main principles:

- Any company, group of companies or any natural person benefits from free access to public procurement. It may apply for a public contract by complying to the requirements set by the rules and regulations.
- There is an equal treatment of candidates and discrimination and obstacles to competition are prohibited.
- There are also efficiency considerations as the procurement procedures must be efficient and provide the contracting authorities with the best services at the best price.

The provisions of Public procurement Code and the decree apply to contracts concluded by contracting authorities such as the state, including its decentralized services and organizations not endowed with legal personality placed under its authority, local authorities;
public establishments; agencies or bodies, legal persons governed by public or private law, other than public establishments, national companies or public limited companies with majority public participation, whose activity is financed mainly by the state or a local community and is carried out mainly in the context of activities of general interest; national companies and public limited companies with majority public participation; and the like.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Senegal (including in relation to public-private partnerships) are:

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders;
- refinancing of the debt in operational projects; and
- asset financing: this is particularly relevant in the rail sector.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

Where there is a presumed compliance requirements violation, the Capital Markets Authority, CREPMF, initiates an investigation when it believes that there a potential violation of the rules and regulations.

Investigations can intervene at any time when the financial market authority considers there is a violation of law. The financial market authority can get information from different actors in the market (shareholders, parent companies and subsidiaries, from any legal or natural person having a direct or indirect relationship of interest with the stakeholders).

This investigation may result in sanctions.

What regulatory penalties may apply?

The regional council, in application of article 30 of the Appendix relating to the Composition, Organization, Functioning and attributions of the CREPMF, can impose disciplinary, financial and administrative sanctions for any action, omission or maneuver that would be contrary to the general interest of the financial market and its proper functioning and / or prejudicial to the rights of savers.

The CREPMF does not have the power to impose criminal sanctions, but it does have the power to pronounce:

- pecuniary sanction
- administrative sanction
- disciplinary sanction
When there is violation of law, the financial authority can apply pecuniary sanctions (fines), administrative sanction (withdrawal or suspension of authorization) and disciplinary sanction. Those sanctions do not prevent the application of criminal penalty.

Those sanctions are imposed without prejudice to legal sanctions which may be pronounced against the offenders on the basis of a claim for compensation brought on an individual basis by aggrieved persons as a result of these conducts (appendix relating to the Composition, Organization, Functioning and attributions of the CREPMF, article 30).

**What criminal penalties may apply?**

The financial regulators have powers to impose criminal penalties in certain cases, against any person who, intentionally:

- does not comply with the restriction, suspension, or prohibition of professional activity that has been notified to it by the Regional Council; (Article 36 of the appendix relating to the Composition, Organization, Functioning and attributions of the CREPMF);
- spreads false information in the public about the stock market and its products;
- performs a stock market maneuver aimed at hindering the regular operation of the market;
- overrides a decision that rejects an application or withdraws a visa taken by the Regional Council;
- infringes the monopolies of stock exchange trading and securities accounts vested in management and intermediation companies; and
- commits an insider trading.

Moreover, in the case of a legal person, the *de jure or de facto* managers will be liable to the same proceedings, if they become aware of those acts.

The financial conduct authority cannot apply criminal penalties. They may just apply the sanctions specified above. Criminal penalties are applied by national court.

**Tax**

**Tax issues**

*Are stamp, registration, transfer or other similar taxes applicable?*

*Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?*

Generally:

Stamp duties of XOF2,000 apply to:

- deeds, documents, their copies and reproductions, drawn up for the general purpose of establishing legal fact or relationship; and
- an act passed abroad is subject to stamp duty before being used in the legal circuit in Senegal.

Registrations fees apply on loan, if declared, as per as the scope of law includes all deeds and legal facts, whether or not recorded in writing.

**Exemptions:**

Exemption for stamp duties on:
• account opening agreements concluded by banks; and
• credit agreements binding decentralized financial systems to their clients.

Registration bonus

• BCEAO’s and AFD’s contracts, apart from the rental or transfer of their buildings;
• sales of shares in companies listed on the Regional Stock Exchange (BRVM);
• leasing contracts; and
• Islamic financing operations.

Registration fees:

Are exempt from the registration formality:

• assignments of receivables under factoring contracts of companies approved by the BCEAO; and
• the deeds of advances on Senegalese state fund securities or securities issued by the Treasury.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Deeds recording the publication of pledge files at the Registry:

• from XOF0 to XOF3 million 5 %;
• from XOF3 to XOF5 million 1.5 %;
• from XOF5 to XOF500 million 1 %;
• from XOF500 million to XOF1 billion 0.5 %; and
• in excess of XOF1 billion 0.25 % and the total amount of fees to be paid in this case may not exceed XOF50 million.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

Registration of transfer of bond in the month of signature of the deed is mandatory. A fixed duty of XOF5,000 shall apply on registration except of deeds or advances on Senegalese government securities or bonds issued by the Treasury;

Stamp duty is also applicable for the amount of XOF2,000 per sheet.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Secured lenders and secured debt security holders take priority over tax authorities on the enforcement of security.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Withholding taxes apply on interest paid under a loan to a destination abroad.
If so:

**What is the rate of withholding?**

The rate is 25% subject to Tax treaty signed by Senegal and 17% for the tax on financial activities.

For payment of interest on fixed term deposit, the rate is 16%.

**What are the key exemptions?** For example, is there an exemption for interest payments to banks, to local lenders/debt security holders, on listed debt, to lenders/debt security holders entitled to the benefit of a double tax treaty etc.?

Exemptions apply on:

- interest on loans, advances, deposits, as well as commissions on signature commitments and similar operations concluded or carried out between banks;
- interest on loans with a term of at least five years on the industrial, agricultural, fisheries or tourism sectors;
- interest on credit distribution operations carried out by the Decentralized Financial Systems;
- interest on loans and advances granted to the state;
- interest received on operations carried out with enterprises established in the Dakar industrial free zone;
- interest on loans granted to natural persons for the construction and acquisition of premises for the purpose of principal residence;
- 8% reduced rate on payment of interest on fixed term deposit paid through a bank account; and
- 7% reduced rate on interest, levied on all export sales financing transactions.

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

The same analysis would apply to interest payments under a debt security.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

A withholding tax applies to interest payments remunerating loans granted by lenders (company) or individuals who do not have a permanent establishment or are not resident in Senegal.

Holders of debt securities are taxable if they are tax resident.

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

The same analysis applies to interest payments under a bond. The General Tax Code subjects the income from non-bond loans to the tax on deposit (IRC) and fixes the applicable rates as follows:

- 16% for income from receivables deposits and guarantees; and
- 8% for income from receivables deposits and guarantees opened in the accounts of a bank, a financial institution, etc.
Key contacts

Mame Ngoné Sow
Senior Associate
DLA Piper Africa, Senegal (GENI & KEBE)
mn.sow@gsklaw.sn
T: +221 33 821 19 16
Singapore

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under Singapore law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Singapore or to request that they are admitted to trading on a regulated market operating in Singapore unless an approved prospectus has been made available to the public.

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What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Singapore are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in Singapore.

Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (ie debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

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What are the differences between offering debt securities to institutional / professional or other investors?

There are additional requirements that would have to be met in order to offer debt securities to retail investors, including the preparation of prospectuses.

The Monetary Authority of Singapore has, however, recently introduced two new frameworks, namely the Bond Seasoning Framework and the Exempt Bond Issuer Framework which will enable retail investors to invest if certain criteria are satisfied.

When is it necessary to prepare a prospectus?

All offers of securities require the preparation of a prospectus unless an exemption is available. Possible exemptions include the issue or transfer of securities for no consideration eg employee share option schemes, small personal offers where the total amount raised from such offers within any 12-month period does not exceed $5 million or such other amounts as may be prescribed by the Monetary Authority of Singapore and an offer to no more than 50 persons within any period of 12 months and under certain conditions.

What are the main exchanges available?

The Singapore Exchange (SGX) has two principal markets on which debt securities are traded:

- the SGX Mainboard; and
- the SGX Catalist.

Is there a private placement market?

Singapore does have an active private placement market and companies would have to comply with the rules of the Singapore Exchange Securities Trading Limited for such placements. Save for the foregoing, there are no specific regulations governing the same.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses, if applicable, for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Singapore law. Singapore has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification with the consent of a majority of the investors. If a trust deed is required, it will typically confer certain discretions on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.
Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing a fund, offering fund securities and operating a fund (ie fund management), among other things, are regulated activities subject to regulation by the Monetary Authority of Singapore.

Collective Investment Schemes

There are additional requirements which apply to activities undertaken in relation to 'Collective Investment Schemes' which are schemes comprising the following arrangements (subject to certain specific exceptions set out in the legislation):

• with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by acquiring any right, interest, title or benefit in the property or any part of the property or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of any right, interest, title or benefit in the property or to receive sums paid out of such profits or income;

• where the participants do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions;

• pooling of investors' contributions and profits or income; and

• the property is managed as a whole by or on behalf of a manager.

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What are common fund structures?

Common forms of funds include:

• open-ended and closed-ended funds;

• retail and non-retail funds;

• collective investment schemes; and

• qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

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What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Retail funds are usually structured as a unit trust and are subject to the Collective Investment Schemes (CIS) regulatory regime, including the CIS code.

For retail schemes constituted in Singapore to be authorized by the Monetary Authority of Singapore, the following would need to be, inter alia, complied with:

• lodging a prospectus with the Monetary Authority of Singapore in compliance with the CIS Code; and

• the requirements of the CIS Code.
Are there any other notable risks or issues around establishing and investing in funds?

There are none to highlight for the summary purposes of this site.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Fund management companies (FMC) must either be a licensed fund management company which has obtained a capital markets services license under the Securities and Futures Act or be a registered FMC. Both applications are made with the Monetary Authority of Singapore. Each of these FMCs can market their own funds.

Further a person licensed under the Financial Advisers Act (Cap. 110) can market a collective investment scheme.

There are also no restrictions on using intermediaries to market a fund provided the requisite capital markets services license is obtained.

Are there any restrictions on managing a fund?

Fund management companies (FMC) must either be a licensed fund management company which has obtained a capital markets services license under the Securities and Futures Act or be a registered FMC.

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

There are no restrictions on entering into derivative contracts.

The Securities and Futures (Reporting of Derivative Contracts) Act, however, applies to all derivative transactions and requires transactions to be reported to the Monetary Authority of Singapore.

What are common types of derivatives?

Derivative contracts are entered into in Singapore for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange. Exchange traded derivatives are also subject to rules under the Singapore Exchange Derivatives Trading Limited.

All of the main types of derivative contract are widely used in Singapore:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).
The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Singapore are:

- equity;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

The derivatives market has seen, and continues to see, the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Although lending itself is not regulated, the business of lending is regulated by the Moneylenders Act. Except for banks, finance companies, merchant banks, pawnbrokers, and cooperative societies, every person who carries on the business of moneylending must be licensed under the Moneylenders Act. Such lenders (including banks or moneylenders) will need to be authorized by the Monetary Authority of Singapore or the Ministry of Law to conduct such business.

There are no specific requirements around how the agreement is drafted and formatted and what information must be included.

There are no additional restrictions that apply to foreign lenders making loans to Singapore borrowers from a Singapore law perspective. However, banks in Singapore that lend Singapore dollars to non-resident financial institutions for any purpose whether in Singapore or elsewhere are subject to restrictions on the amount that they can lend.

Specific restrictions on lending apply to the purchase of real property, as follows:

- An absolute limit of 35 years on the tenure of all loans for residential property, applies to loans to both individual and non-individual borrowers, as well as refinancing loans, from 6 October 2012.

- The Monetary Authority of Singapore will lower the loan-to-value ratio (LTV) for new residential property loans to borrowers who are individuals if the tenure exceeds 30 years or the loan period extends beyond the retirement age of 65 years. For these loans, the LTV limit will be:

  - 40% for a borrower with one or more outstanding residential property loans; and
  - 60% for a borrower with no outstanding residential property loans.

- The LTV for residential property loans to non-individual borrowers from 50% to 40%.

Further, under the Total Debt Servicing Ratio framework, property loans extended by a financial institution should not exceed a Total Debt Servicing Ratio threshold of 60%. Property loans in excess of the Total Debt Servicing Ratio threshold of 60% should only be granted on an exceptional basis (or unless otherwise exempted under the Total Debt Servicing Ratio framework) and financial institutions should clearly
Borrowing

There are specific restrictions on borrowing for unsecured credit an individual:

- 24 times monthly income from 1 June 2015;
- 18 times monthly income from 1 June 2017; and
- 12 times monthly income from 1 June 2019.

Financial institutions will not be allowed to grant further unsecured credit to an individual whose unsecured borrowings exceed the prevailing borrowing limit for three consecutive months.

Further, the Monetary Authority of Singapore has issued a consultation paper on 30 September 2016 proposing to disallow financial institutions from granting new unsecured credit facilities or credit limit increases to individuals whose outstanding unsecured debt already exceeds 12 times their monthly income. The Monetary Authority of Singapore has stated in the consultation paper that it intends to implement the changes on a prospective basis from 1 June 2017.

What are common lending structures?

Lending in Singapore can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfill certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but may sometimes come with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

For more information see Lending and borrowing – restrictions.

Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of Singapore law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. For example, the Singapore courts will not enforce a penalty and so lenders have to be careful about the rate of default interest charged on a loan. It should be noted though that a contract by an unlicensed moneylender renders the borrower's obligation to repay unenforceable.

Specific types of lending

For more information see Lending and borrowing – restrictions.

Standard form documentation

Finance transactions are likely to be documented on bank standard form documentation prepared in-house which are then subject to negotiations between the bank and the borrower.

Are there any other notable risks or issues around borrowing?

There are no notable risks or issues around borrowing.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.
Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative. Under Singapore law, directors must act bona fide for what they consider to be in the best interests of the company and not for any collateral purpose; as such, they will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

Insolvency

Guarantees and security may be at risk of being set aside under Singapore insolvency laws if the guarantee or security was granted by a company with a certain period of time prior to the onset of insolvency. This would be the case if the company giving the guarantee or security received considerably less consideration, and as such, the transaction was at an undervalue. For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within six months (or two years for connected parties) before the presentation of a winding-up petition. Guarantees and security may also be challenged on other grounds relating to insolvency.

Financial assistance

It is unlawful for a public company to provide financial assistance for the purchase of its own (or of its holding company's) shares unless a whitewash resolution is obtained from the shareholders. The prohibition against financial assistance for private companies whose holding company or ultimate holding company is not a public company was abolished on 8 October 2014. Financial assistance in this context would include giving a guarantee or security in connection with the share purchase.

What are common types of guarantees and security?

Common forms of guarantees

Guarantees can take a number of forms.

A particular distinction worth remembering is between a performance guarantee and a payment guarantee:

- A performance guarantee is a term used to describe both performance bonds (in the context of trade finance) and ‘see to it’ guarantees (in other contexts):
  - A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract. However, note that unlike a guarantee, the essential difference is that the obligation to pay is intended to be unconditional and independent of the underlying obligation. The essence of a ‘true’ performance bond is that it is an unconditional undertaking by a third party to pay the beneficiary upon demand, independent and irrespective of the underlying contract between the beneficiary and the principal. The issuer of a performance bond has primary liability, unlike a guarantor, who has secondary or collateral liability.
  - A ‘see to it’ guarantee is a promise by the guarantor to see to it that the primary obligor fulfils its obligations under the primary contract. If the primary obligor fails to fulfil its obligations under the primary contract, the guarantor will be in breach of its obligations under the guarantee.
- A payment guarantee is narrower in scope than a performance guarantee as it only covers the payment of money rather than other contractual obligations.

Common forms of security

There are four basic types of security interest that can be created under Singapore law:
• a pledge;
• a lien;
• a charge; and
• a mortgage.

Different types of security are suitable for securing different types of assets.

Under Singapore law it is possible to grant security over all of the assets of a Singapore company or individual assets. Granting security over all of a company’s assets will tend to be achieved by way of a debenture which will include:

• a mortgage over real estate;
• a fixed charge over assets which are identifiable and can be controlled by the creditors (such as equipment);
• a floating charge over fluctuating and less identifiable assets (such as stock); and
• an assignment by way of charge over receivables and contracts.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing, signed by the guarantor and provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations will usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this should not be an issue. Also it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary, for example between the borrower and lender. As a result guarantees are sometimes executed as deeds to avoid any argument about whether good consideration was provided. Deeds have particular execution requirements namely under seal under Singapore law which need to be observed.

Additionally, there is a risk that a guarantee may be set aside if it was procured by undue influence by a borrower or lender. A party being provided with a guarantee should be alive to this issue and take steps to avoid claims of undue influence by, for example, requiring the guarantor to take separate legal advice. Additionally, a guarantee can be vitiated by misrepresentation, unconscionability, mistake and other like factors such as duress.

Giving or taking security

A security document may need to be executed as a deed if it:

• contains a mortgage over land;
• confers a statutory power of sale and power to appoint a receiver; or
• contains a power of attorney.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the security and notice being given to third parties. Most charges created by a Singapore company must be registered at the Accounting and Corporate Regulatory Authority of Singapore within 30 days of its creation. Failure to register within this time will typically mean that the charge will be void against the liquidator and any creditor of the company.

There are no notarization requirements for security documents under Singapore law.
Like guarantees, for a period after a new security interest has been granted, it is at risk of being set aside in certain circumstances under insolvency laws. Reviewable transactions include those conducted at an undervalue, unfair preferences and invalid floating charges.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Banking Act
Finance Companies Act
Monetary Authority of Singapore Act
Hire-Purchase Act
Payment System (Oversight) Act 2006
Securities and Futures Act
Securities and Futures (Licensing and Conduct of Business) Regulations
Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005
Code on Collective Investment Schemes

Consumer credit

Consumer Protection (Fair Trading) Act

Mortgages

Land Titles Act
Registration of Deeds Act

Corporations

Companies Act

Funds and platforms

Financial Advisers Act
Financial Advisers Regulations
Insurance Act

Other key market legislation

Moneylenders Act
Limited Liability Partnership Act
Monetary Authority of Singapore (Control and Resolution of Financial Institutions) Regulations 2013

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Regulatory authorization
Who are the regulators?

The Monetary Authority of Singapore is the central bank of Singapore and the main regulator for all financial regulated activities. The Accounting and Corporate Regulatory Authority is the regulator of business entities and other corporate service providers.

Last modified 20 Oct 2017

What are the authorization requirements and process?

To conduct a regulated activity in Singapore in the financial services sector, a firm must apply to the Monetary Authority of Singapore for authorization if applicable. As the main regulator, the Monetary Authority of Singapore authorizes a firm under legislation applicable to the regulated activity it conducts. Commercial banks are primarily authorized under the Banking Act, financial advisors are authorized under the Financial Advisers Act and capital markets intermediaries are authorized under the Securities and Futures Act.

To obtain authorization, a firm must apply to the Monetary Authority of Singapore with supporting documentation such as constitutional documents, financial information and business plans and must also fulfill all requisite criteria.

Under the Securities and Futures Act, an application fee ranging from S$200 to S$1,000 must be paid, depending on the authorization sought. The application fee is regulated under the Securities and Futures Act. Prospective applicants who intend to conduct banking business in Singapore are encouraged to contact the Monetary Authority of Singapore at an early stage to discuss plans prior to submitting a formal application.

Authorized firms are listed in the Financial Institutions Directory of the Monetary Authority of Singapore.

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What are the main ongoing compliance requirements?

Ongoing compliance requirements differ depending on the type of license obtained. Typically, threshold conditions regarding the maintenance of adequate financial resources and reporting requirements are ongoing requirements for authorized firms. An annual license fee is also typically payable.

The Monetary Authority of Singapore may take regulatory and enforcement action for a failure to comply with ongoing compliance requirements, resulting in sanctions for regulated entities including a possible revocation of authorization.

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What are the penalties for failure to be authorized?

A person (including a company) conducting a regulated activity without being authorized or exempt commits an offence and is liable to fines ranging from S$2,000 to S$250,000 and imprisonment (if applicable), or both.

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Regulated activities

What finance and investment activities require authorization?

Generally

The following are key areas of finance and investment activities regulated and/or requiring authorization in Singapore:

- commercial banking activities including receiving money on current or deposit account, paying and collecting checks and making advances to customers and in particular (merchant banking activities must be conducted and operated within the Guidelines for Operation of Merchant Banks issued by the Monetary Authority of Singapore);
- finance companies in the business of, *inter alia*, borrowing money from the public by acceptance of deposits and issuing certificates or other documents acknowledging indebtedness to the public, as well as providing credit facilities;
- insurers carrying on insurance business in Singapore, including direct life and/or general insurance business, life and/or general reinsurance business or captive insurance;
- activities relating to securities, futures and fund management, including, among other things, dealing in securities, trading in futures contracts, leveraged foreign exchange trading, advising on corporate finance, fund management, real estate investment trust management, securities financing, providing credit rating services and providing custodial services for services;
- financial advisory services, including advising others on investment products, issuing research reports covering investment products, marketing of collective investment schemes, and arranging life policies for others, other than a contract of reinsurance;
- money brokers who provide broking services dealing with banks and financial institutions licensed, approved, registered or regulated by the Monetary Authority of Singapore for direct access to money brokers in Singapore;
- money-changing and remittance business involving the buying and selling of foreign currency notes;
- business trusts that run and operate business enterprise;
- trust companies which provide trust or trustee services for investment and wealth management purposes, such as succession planning; and
- payment and settlement systems.

*Are there any possible exemptions?*

Where finance and investment activities, taken as a whole, fall within the remit of multiple pieces of legislation, entities may be exempt from the multiple authorization and/or licensing requirements under applicable legislation. For example, where banks provide capital markets and financial advisory services, the *Financial Advisers Act*, the *Securities and Futures Act* and the Banking Act are applicable to their regulated activities but they are generally exempt from licensing requirements pursuant to the Financial Advisers Act and the Securities and Futures Act.

*Do any exchange controls or other restrictions on payments apply?*

Singapore does not operate any foreign currency controls.

There may be anti-money laundering and tax considerations to take into account. Depending on the way the business is conducted, an analysis on whether a remittance license is required should be conducted.

*What are the rules around financial promotions?*

**Rules**

The *Monetary Authority of Singapore* issued principle-based Guidelines on Standards of Conduct for Marketing and Distribution Activities which took effect from 1 April 2017. These guidelines set out safeguards that financial institutions should apply when marketing and selling financial products and services to retail customers.

**Exemptions**

The Guidelines on Standards of Conduct for Marketing and Distribution Activities apply to financial institutions which conduct marketing and distribution activities targeting retail customers only, and the representatives who act on behalf of these financial institutions.
Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most commonly used legal entity is a limited company, which is a body corporate with separate legal personality and which limits the liability of its members.

Limited companies can either be private (denoted by the suffix Private Limited, Pte Ltd, Sendirian Berhad or Sdn Bhd) or public (denoted by the suffix Limited, Ltd or Berhad). At least one director of a limited company must be ordinarily resident in Singapore. There are no minimum share capital requirements to set up a company in Singapore, however, companies which intend to carry on regulated business (such as banking, money lending or fund management activities) may be subject to minimum capital requirements.

The number of members in a private company limited by shares is restricted to a maximum of 50. The constitution of a private limited company must provide for restrictions on the transfer of shares by its members, for example by providing that transfers require the approval of directors or imposing a right of first refusal for existing members.

There is no limit on the number of members of a public limited company, however, if a public limited company is listed on the Singapore Exchange Securities Trading Limited, at least 10% of the issued shares in each class listed must be publicly held. Such public listed company would also be subject to the Rules of the Singapore Exchange Securities Trading Limited.

A company may convert from private to public or public to private by special resolution of its members and lodging certain documentation with the Accounting and Corporate Regulatory Authority of Singapore.

A limited liability partnership (LLP) established under the Limited Liability Partnership Act may also be used. Like a company, a LLP has a separate legal personality. At least one manager of the LLP must be ordinarily resident in Singapore.

Funds

Investment funds typically take the form of:

- a collective investment scheme structure, being a trust established using a trust deed between a manager and trustee;
- a corporate entity; or
- a limited partnership structure.

Fund management activities must be conducted by a company incorporated in Singapore, which must hold a Capital Markets Services license for fund management. The relevant persons (as defined in guidelines issued by the Monetary Authority of Singapore), must be, inter alia, considered ‘fit and proper’ by the Monetary Authority of Singapore. There are certain exemptions from such requirements under the Securities and Futures Act.

Is it possible to conduct lending or investment business through a branch or establishment?

A branch office without a separate legal identity from that of its parent company may be registered in Singapore, which may conduct any business activities conducted by its parent company. The branch office must have the same name as its parent company and it must comply with the Companies Act, for example provisions requiring the branch office to have its registered office address in Singapore and to appoint an authorized representative who is ordinarily resident in Singapore. Approval of the Monetary Authority of Singapore may be
required in certain circumstances. For applicants that are incorporated in a foreign country, they should satisfy the Monetary Authority of Singapore that the branch in Singapore would be subject to proper management oversight and be able to comply with all laws and regulations governing its operations.

Alternatively, a subsidiary private limited company may be incorporated in Singapore with a legal identity separate from its parent company.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Overview

The Singapore government and the Monetary Authority of Singapore (MAS) have actively encouraged the growth of the FinTech industry to entrench Singapore as a global financial hub and further its initiative to transform Singapore into a ‘Smart City’. Compared to Western markets, market and consumer maturity in Southeast Asia is lower since a large part of the population is underbanked or unbanked and has limited access to smart technologies. This presents different challenges for companies wishing to enter the FinTech space and for FinTech investors, as entrepreneurs are limited in the extent to which they can employ technological advances in their innovations.

In Singapore, FinTech innovations are within the payments and marketplace lending space, which provide platforms for new consumers to access traditional banking services.

Peer to peer funding and marketplace lending

Peer-to-peer (P2P) funding includes both P2P lending and P2P equity platforms. Unlike traditional banks, P2P lending firms operate a platform which connects borrowers and lenders, instead of applying funding raised from a deposit-based relationship. Furthermore, while P2P lending platforms were initially used mainly to help startups raise capital, they now operate across many industries and finance assets which could previously only be financed by bank funding. Examples include lending platforms which deal in consumer loans, real estate or student lending.

P2P lending platforms and other forms of marketplace lending have presented an ever increasing challenge to traditional financial service providers largely because their technological innovation leads to greater efficiency, cost savings and flexibility and their ability to service small and medium-sized enterprises (SMEs) that have been turned down by traditional banks in the post financial crisis era.

MoolahSense (set up in 2014) and FundingSocieties (set up in 2015) were some of the successful early pioneers of marketplace lending in Singapore. They have entered into a partnership with DBS Bank to refer successful borrowers to the bank for larger loans and other traditional banking services. FundedHere and Crowdo are other key marketplace lending players, and they provide both equity and lending based platforms. We can expect to see a longer list of crowdfunding platforms in time to come, as the number of platforms receiving licenses from the MAS is increasing.

Industry specific platforms have also taken off in Singapore. One example is CoAssets – a Singapore grown, Australian listed crowdfunding platform founded in 2013 – which focuses on real estate funding. Another example, Crowdo, earlier this year announced a strategic partnership with BFI Finance, a multi finance company in Indonesia, to offer customers (particularly SMEs) loans for vehicles and fixed assets.

Many of these domestic funds have also been expanding their operations to include securitizing loans through invoice financing which is particularly favorable for asset light SMEs.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes P2P-type structures often operated through an electronic platform provider as well as crowdfunding and
also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

In general terms, marketplace lending has not been as successful in Singapore as it has been in the US or the UK, mainly because the local financial market is not large enough to achieve the scale and success of American P2P platforms such as Lending Club. This is a difficult challenge to overcome for Singapore's relatively small domestic funds since they do not have access to the kind of business/investor data that banks have access to and since not many P2P platforms have partnered with banks in Singapore, unlike in the UK or US.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

There seems to be a great push to make Singapore a world leader in distributed ledger technology with many users in Singapore testing the application of blockchain in areas such as:

- interbank payments;
- verifying and reconciling trade finance invoices; and
- executing and verifying the performance of contracts.

Examples of FinTechs in the blockchain space include Attores, a Singaporean FinTech startup which utilizes the ethereum platform (a blockchain that records smart contracts) to allow its customers to create and execute tailored smart contracts securely, while building an open repository of smart contracts. In September 2017, IBM announced it was piloting blockchain technology for managing the design, management and execution of its contracts with Bank of Tokyo Mitsubishi on the IBM cloud.
The Singapore government, acting through its FinTech office, is taking the lead in developing the application of blockchain technology in Singapore. The FinTech office was set up in May 2016 by the MAS and the National Research Foundation, to serve as a one-stop virtual entity for all FinTech matters and to promote Singapore as a FinTech hub. In a keynote address in November 2016, the Managing Director of the MAS expressed that there was an important opportunity for the government to build blockchain infrastructure that the private sector could meaningfully use. He discussed examples in banking, KYC, consent standards in big data and payment infrastructure for mobile payments as possible areas within which blockchain could be successfully deployed. However, attracting and recruiting talent and developing local talent remains an important challenge for the Singapore government, which it is actively trying to overcome the issue by hosting events such as the annual FinTech festival since November 2016 (for more information, see here).

In March 2017, the MAS completed phase 1 of a proof-of-concept project named ‘Project Ubin’ to conduct domestic inter-bank payments using blockchain. The project was formed in partnership with R3 and a consortium of financial institutions, and was borne out of a need to explore the use of blockchain in financial transactions. The project evaluated the implications of having a tokenized form of the Singapore dollar (SGD) on a distributed ledger, and its potential benefits to Singapore's financial ecosystem. If blockchain-based interbank payments are successful, it could lead to faster settlements in securities and bond trading. The report for the project, however, mentioned the potential issue of credit risk liability and stated that an appropriate legal structure is required to ensure that the transfer of digital SGD is equivalent to a full and irreversible transfer of the underlying claim on the central bank's currency. This would help ensure that there is no credit risk associated with the creation, distribution, use or redemption of the digital SGD.

With an unprecedented push for the adoption of blockchain led by Singapore's government, Singapore is on its way to being at the forefront of the technology, and perhaps an example of how blockchain can work to improve the lives of its citizens.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

As defined by the Monetary Authority of Singapore, a digital token is a cryptographically secured representation of a token holder's right to receive a benefit or perform a specified function. A virtual currency (examples include bitcoin or ether), also known as cryptocurrency, is a type of digital token.

Initial coin offerings and token based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty initiative or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is
illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

ICOs have become increasingly popular as a way for startups in Singapore to raise funding. Millions of US dollars have been raised through ICOs in Singapore over the last year. Digix, a platform which trades gold backed tokens issued for ethereum, raised US$5.5 million in under 12 hours in 2016, while blockchain startup TenX recently raised close to US$80 million to support the development of a protocol enabling transactions across different blockchains.

TenX is only one of many startups in the digital tokens and cryptocurrency based products space which has raised money to help finance or support the development and application of cryptocurrencies and other tech startups in Singapore. Cofund.it provides a platform much like a P2P lending or equity funding platform to connect startups in the blockchain and cryptocurrency space to investors and experts for both funding and advice. Cross Coin, a Singapore special purpose vehicle, raised US$5 million in one day through an ICO to fund and develop 60 to 70 Russian and Eastern European technology startups in Starta Accelerator, a New York accelerator. FundYourselfNow, which dubbed itself as the first cryptocurrency crowdfunding platform in Southeast Asia, has created a platform to allow entrepreneurs to raise funds for their projects using virtual currencies such as bitcoin or ethereum, instead of regular currency.

Other startups such as Coss and HelloGold Foundation aim to bring cryptocurrencies to the mass market by adopting crypto and blockchain based services and products into a user friendly and intuitive environment.

For information on the regulation of ICOs, see FinTech products and uses – particular rules.

**Artificial intelligence and robo advisory systems**

Digital advisory systems which employ artificial intelligence, such as robo advisory systems, have become increasingly popular in Singapore over recent years. As defined by the MAS, digital advisory services refer to the provision of advice on investment products using automated, algorithm based tools, usually online and with limited or no human interaction.

Since the availability of digital advisory services will increase investor choice and market competition and provide access to low cost investment advice, the MAS has refined the licensing and business conduct requirements for digital advisory service providers.

Digital advisors may operate with a capital markets services license (CMSL) for fund management or for dealing in securities under the Securities and Futures Act (SFA), or a financial advisor's license under the Financial Advisers Act (FAA), depending on their business models and the specific activities that they undertake. Current regulations mean that financial institutions which are already regulated under the
SFA or the FAA can provide digital advisory services. In line with this, OCBC Bank Singapore recently announced plans to launch a robo advisory service targeted at accredited investors, in partnership with WeInvest. Bambu, a Singapore business-to-business robo advisor services provider, has developed a white label platform for financial institutions to offer robo advisory to their customers. One of their offerings is called ‘Robo-in-a-box’, which is a one-stop-shop for any company to offer end-to-end digital solutions to retail investors. Another one is called the ‘Intelligent Advisor’, which is a propriety algorithm-ranking tool for relationship managers to improve customer experience targeted at high-net-worth investors. Bambu has signed partnerships with notable industry players including Tigerspike, Thomson Reuters and Finantix.

In June 2017, the MAS released a consultation paper on proposals to facilitate the provision of digital advisory services. These proposals discuss the governance, supervision and management of algorithms for robo advisors to ensure integrity and robustness in the delivery of financial advice. At the same time, the MAS recognizes that some digital advisors whose activities fall into fund management and who intend to obtain a CMSL in fund management to service retail investors may not be able to meet the five-year corporate track record requirement of managing funds for retail investors in a jurisdiction which has a regulatory framework that is comparable to Singapore.

In order to make it easier for entities offering digital advisory services to operate in Singapore, among other concessions, these proposals state that the MAS is prepared to admit digital advisors (which operate as fund managers under the SFA) to offer their services to retail investors even if they do not have a five year corporate track record or do not meet the minimum total assets under management requirement (S$1 billion), provided they meet safeguards such as:

- offering diversified portfolios of non complex assets;
- having key management staff with relevant collective experience in fund management and technology; and
- undertaking an independent audit of the advisory bureau within one year of operations on key risk areas (i.e. prevention of money laundering and countering the financing of terrorism, handling of client moneys and assets, technology risk and suitability of advice).

However, the MAS would require the providers of digital advisory services to manage the new technology risks associated with these activities. The public consultation on these proposals ended on 7 July 2017 but the proposals have not yet been finalized.

**Data analysis and cloud computing**

Cloud computing refers to the use of a network of remote servers hosted on the internet to store and process data, instead of relying on a local server or personal computer. It provides economies of scale, delivers operational efficiencies and, like data analysis, is an enabler for a variety of other FinTech innovations.

There has been a growing trend among financial institutions to outsource aspects of their service delivery to cloud operators. In July 2017, as part of its Guidelines on Outsourcing Risk Management, the MAS set out specific guidelines on the use of cloud services by financial industry players. These mainly required cloud service providers to be aware of the risks to data confidentiality and data recovery posed by cloud services such as multi location processing and to carry out the necessary due diligence and implement appropriate risk management processes.

In this light touch regulatory environment, many startups have begun innovating in the cloud computing and data analytics space. Smartkarma and Call Level, both founded in 2014, provide services based on data analysis for investors. Call Level simplifies tracking investors’ personal investments using tailored notifications which are generated from market analysis whereas Smartkarma provides research and transparency into Asian markets, combining intelligence from analysts, data scientists, academics and industry experts, to help investors enhance returns and proactively manage their investment strategies.

Business-to-business (B2B) platforms such as Matchmove, which provides cloud computing services to enterprises (in the form of a fully customizable secure mobile wallet service) to help businesses increase customer loyalty and user engagement are also popular in Singapore. Innovation using data analysis is also being deployed in the B2B services arena. FitSense is an analytics platform that collaborates with insurance companies to provide data analytics which allows insurance companies to personalize policies for anyone with a smartphone or wearable technology, thereby reducing insurance premiums.

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**
General financial regulatory regime

GENERAL

Singapore has recently announced plans to become a ‘Smart Nation’ and it has recognized that the financial sector is ideally placed to play a leading role since the financial services industry offers vast scope for innovation and the application of technology. The government aims to work towards a ‘Smart Financial Centre’ where technological innovation is pervasive.

The Securities and Futures Act (SFA) is the main legislation regulating capital markets and the financial investments sector. Section 82 of the SFA provides that no person shall, whether as principal or agent, carry on business in any prescribed regulated activity or hold himself out as carrying on such business unless it holds a capital markets services license (CMSL) issued by the Monetary Authority of Singapore (MAS) in respect of that prescribed regulated activity. Regulated activities include dealing in securities, fund management, advising on corporate finance, providing custodial services for securities and securities financing, amongst others. Therefore, generally, unless a licensing exemption is invoked, all financial institutions would be required to obtain a CMSL. In some instances, the Financial Advisers Act may also be applicable.

The MAS is the main financial services regulator in Singapore. Generally, the MAS’s regulatory approach towards FinTech can be described as activity-based regulation to keep pace with innovations. MAS believes that regulation must not front-run innovation since this may stifle or potentially derail innovation or the adoption of useful technology. However, it puts equal emphasis on keeping pace with innovation in order to assess what the risks might be and continually evaluates whether it is necessary to regulate or leave technologies and industries to evolve further. The MAS will only bring regulation in when the risk posed by new technology becomes material or crosses a threshold. Any regulation ought to be proportionate to the risk posed.

In order to provide a safer, less expensive and more controlled environment within which FinTechs can innovate, the MAS has set up a regulatory sandbox framework for financial institutions to test their innovations. This will provide FinTech firms with a space within which to experiment with their technology, even if they are not able to anticipate every risk or meet every regulatory requirement.

To enter the regulatory sandbox, the relevant FinTech must apply to the MAS. The MAS and the applicant will then define the boundaries within which the experiment will take place. The MAS will also determine the specific legal and regulatory requirements, which it is prepared to relax for the duration of the experiment within these boundaries. The sandbox has been a huge success, attracting proposals that leverage on a range of technologies, including blockchain, machine learning and big data analytics. PolicyPal, an insurance technology startup which allows customers to buy and manage insurance policies through a mobile application, is the first ‘graduate’ of the sandbox.

Regulation of peer-to-peer funding and marketplace lending

The MAS announced initiatives in June 2016 to improve small and medium-sized enterprises' access to equity and lending-based crowdfunding from accredited and institutional investors by relaxing certain financial requirements for capital markets intermediaries that deal in securities and clarifying the application of certain exemptions from prospectus requirements. Its approach is to regulate equity and lending-based crowdfunding platforms within the existing regulatory framework and accept lower regulatory requirements in accordance with the risks and characteristics of the business model (eg serving only accredited investors and institutional investors, and not handling clients’ monies) of the relevant entity. The MAS does not see a need to create a new investor class for equity or lending based crowdfunding since the framework is already calibrated to treat retail and non-retail investors differently. As at June 2016, in light of the high risks inherent in equity crowdfunding, the MAS does not intend to remove the regulatory safeguards such as prospectuses that apply where securities are offered to retail investors but is working to refine its guidelines to facilitate the intermediation of offers to investors (including retail investors) under the existing framework and continues to monitor developments and may make adjustments to the approach in the future, if warranted.

CMSL REQUIREMENT

Generally, an equity and lending based crowdfunding platform operator will require a CMSL since it will be dealing in securities (ie by facilitating the offer of debentures even if the platform operator does not itself offer the debentures) or advising on corporate finance (as defined in the Securities and Futures Act) unless it qualifies under one of the prescribed exemptions from the requirement to hold a CMSL. Requirements under the Financial Advisers Act may also apply where financial advisory services are provided by the platform operator to investors who wish to invest in the securities.

Following a public consultation held in 2015, the MAS has simplified the financial pre-qualifications to be met by platform operators to allow them to obtain a CMSL for dealing in securities. Therefore, if the platform operators only serve accredited and institutional investors,
do not hold or handle customer money, assets or positions and do not act as principal against customers, the base capital requirement for dealing licensees will be reduced from $250,000 to $50,000 and the requirement to maintain a security deposit of $100,000 with the MAS will be removed.

In assessing corporate license applications, where an applicant platform operator does not possess the requisite five years' corporate track record (as set out in the Guidelines on Criteria for the Grant of a CMSL other than for Fund Management), the MAS will consider other factors in place of the corporate track record, such as the experience and track record of the shareholders and the key officers of the applicant.

**Offer of Securities**

In addition to the requirement to have the appropriate CMSL, under section 239(3) of the SFA, any invitation to lend money to an entity (eg a company) is deemed to be an offer of debentures, which is a type of security. The entity offering debentures is required to prepare and register a prospectus with the MAS in accordance with the SFA unless it falls within one of the several prospectus exemptions.

Currently, securities-based crowdfunding (SCF) can be carried out, albeit in a limited way, without the need to register a prospectus if it is done in reliance on existing prospectus exemptions, such as the small offer exemption under the SFA.

Under section 272A of the SFA, crowdfunding platform operators may make personal offers of securities, up to $5 million within any 12 month period, without a prospectus (referred to as the small offers exemption), subject to certain conditions. As of June 2016, the MAS has amended the investor pre-qualification process found in the MAS's Guidelines on Personal Offers made regarding the Exemption for Small Offers in order to make it easier for SCF platform operators to rely on the existing regulatory framework for small offers, to raise funds through SCF including from retail investors. However, to ensure investors (including retail) are fully aware of the risks and deterred from investing if they are unable to accept the potential losses, the MAS has concurrently strengthened the existing risk disclosures to require any licensed crowd-funding platform operator appointed by an offeror to intermediate the offeror's small offers online; and such an offeror is to provide, at the minimum, a prescribed risk disclosure statement to each potential investor and obtain the investor's acknowledgement that he is fully aware of and accepts the risks. The MAS has also advised however that in appointing a licensed SCF platform operator to intermediate the offeror's small offers, the offeror should satisfy itself that the SCF platform operator has the necessary procedures to ensure that the revised pre-qualification process, as well as the revised risk disclosure and acknowledgement requirements, are complied with.

Offerors can also rely on prospectus exemptions under sections 274 and 275 of the SFA to make offers of securities to accredited investors and institutional investors through SCF without a prospectus. To ensure that offers made in reliance of the abovementioned prospectus exemptions are limited in scope and reach, and are not subject to mass solicitation, offers to accredited investors are subject to specified conditions, including a restriction on any advertisement on the offer (Advertising Restriction). Although the MAS has clarified the scope of the advertising restriction for offers made pursuant to the prospectus exemptions, the bottom line remains that as exempted offers are intended to be offers that are restricted in scope, these offers should not be subject to any mass solicitation, advertising or canvassing. If the platform operator of a ‘restricted access platform’ (as opposed to an ‘unrestricted access platform’) has conducted due diligence to confirm that investors who have access to the platform are within the scope of the prospectus exemption (eg accredited investors), the publication of statements containing information on the offeror and the terms of the offer on the platform would not be regarded as a breach of the Advertising Restriction.

Licensed platform operators may still offer equity securities to retail investors by registering and providing a prospectus or by utilizing some of the other statutory exemptions (such as the small offers exemption described above) to issuing a prospectus.

**Regulation of payment services**

Payment services are currently governed by two separate pieces of legislation: the Money Changing and Remittance Businesses Act (MCRBA) which governs stored value and the Payment Systems (Oversight) Act (PS(O)A) which governs remittance businesses. With the advent of FinTech, payments and remittances and the providers of these services can no longer be easily classified and differentiated.

In August 2016, the MAS released a consultation paper on the proposed changes to the payments regulatory framework and the establishment of a National Payments Council to drive innovation, as well as to create a more efficient and competitive business environment. The proposals bring payment services regulations under a single framework that will provide for the licensing, regulation and supervision of all payments services including stored value facility holders, remittance companies and virtual currency intermediaries. Regulation will be applied on the basis of the activity carried out by the service provider and entities will only be required to apply for a single license to undertake several payment activities. The proposed regulation also aims to strengthen standards of consumer protection, anti-money laundering and cybersecurity related to payment activities.
The consultation was the first in a series of consultations on the proposed governance model for Singapore. The proposals from these consultations do not yet appear to have been implemented.

**Regulation of Initial Coin Offerings (ICOs), cryptocurrencies and token based products**

In light of the booming ICO market in Singapore, the MAS clarified in August 2017 that the offer/issue of digital tokens which constitute ‘products’ regulated under the SFA will be regulated by the MAS. Where tokens fall within the definition of securities in the SFA, the issuer is subject to licensing requirements under the SFA (unless exempt) and is required to lodge and register a prospectus with the MAS prior to the offer of such tokens (unless exempted). Any platform facilitating the secondary trading of these tokens would also have to be approved or recognized as an approved exchange or recognized market operator under the SFA.

In line with other countries, the MAS has previously confirmed that virtual currencies are not specifically regulated but that intermediaries in virtual currencies would be regulated for money laundering/terrorist financing risks. It is considering introducing regulations to prevent money laundering/terrorist financing risks involving digital tokens which are not virtual currencies, in the near future.

**Application of data protection and consumer laws**

The increasing sophistication and use of technology within FinTech, data analysis tools and the applications of big data means that more data than ever is being collected and stored. Data protection in Singapore is governed by the Personal Data Protection Act 2012 which fully came into effect in 2014. It governs the collection, use, disclosure and care of personal data (whether electronic or non-electronic) and recognizes individuals’ rights to protect their personal data and their rights of access and correction.

**Money laundering regulations**

In order to be compliant with anti-money laundering regulations, companies operating in the FinTech sector must collect the right information to conduct appropriate ‘know your customer’ procedures. This includes determining the business model’s risk of money laundering and carrying out enhanced due diligence if the model is high risk. FinTech companies dealing with online payments and internet-based stored value facility holders are two sub-categories which have been identified as high risk. The MAS has issued guidance papers and ‘Notices on the Prevention of Money Laundering and Countering the Financing of Terrorism’ for different types of FinTech business models. These outline the specific requirements and standards to be met by each type of institution.

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders, other high net worth individuals (often known as angel investors) or equity crowdfunding investors in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know how and expertise to assist in the company's development. Seed investors would typically not require the same controls over the business as, for example, venture capital providers.

Investors may also apply to the Singapore government’s Angel Investors Tax Deduction Scheme between 1 March 2010 and 31 March 2020. If approved as an angel investor, the investor will receive a 50% tax deduction of the investment at the end of a two year holding period when he or she commits a minimum of S$100,000 in a qualifying startup.

The Singapore government also stimulates private sector investments into innovative Singapore-based technology startups with strong intellectual property rights and market potential through its Startup SG Equity Scheme by co-investing in them with an independent, qualified third-party investor. The government’s Startup SG Founder Scheme aims to provide mentorship support and startup capital grants to first-time entrepreneurs with innovative business concepts. This scheme provides up to S$30,000 by matching S$3 to every S$1 raised by the entrepreneur.
In relation to equity crowdfunding, the sector is well established in Singapore and may be appropriate for a FinTech business in the early stages since they often have limited cashflow, making it easier for them to offer shares in exchange for services or investment in the business. Reward-based crowdfunding, where investors will receive tangible benefit to a product that a startup is developing, is also used in Singapore but more commonly found in the entertainment or fashion industry where consumers may feel a stronger personal affinity towards the products.

ACCELERATORS

There are various incubators or accelerators in the Singapore market which offer support, facilities and funding for startups, often in return for an equity stake. For example:

- The incubator fund Expara (which works closely with the Singapore government) provides services, mentorship and training, and invests money in innovative enterprises including FinTech companies and has previously invested in market-leading FinTech players such as CoAssets (the first listed marketplace lending platform in Asia) and 2C2P (a payment services provider).

- United Overseas Bank worked with SGInnovate (a government-backed technology agency) to create FinLab, a FinTech-focused accelerator initiative that successfully produced a number of interesting FinTech companies in 2016 (including Attores, CardUp and Nickel) and is currently off and running for its second cohort.

In order to support accelerators, the Monetary Authority of Singapore (MAS) runs the Startup SG Accelerator which provides funding and non-financial support to further enhance incubators’ initiatives and expertise in nurturing high potential startups.

Venture capital and debt

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions. The benefit of having a venture capitalist as an investor for a FinTech startup is that the VC is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

In order to promote venture capital financing for enterprises and in recognition of the factors differentiating a VC fund from other investment funds, the MAS published a consultation paper in February 2017 proposing a simplified authorization process and regulatory framework for venture capital managers and plans to implement the new rules towards the end of 2017. These proposals focus primarily on the fitness and proprietary assessment of VC managers. Therefore, unlike fund managers, VC managers will not be required to have experience as directors and representatives with at least five years of relevant experience in fund management and they can expect a shortened application process. To the extent that there are contractual safeguards to provide sufficient protection to a VC’s sophisticated consumer base, the MAS is also looking to exempt VC managers from the business conduct requirements applied to asset managers in general.

An additional funding option is venture debt, which is typically structured as a three year term loan (or series of loans), which is secured against a company’s assets and includes an equity element allowing the debt provider to acquire shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

Platform lending

Peer-to-peer (P2P) lending platforms bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead interest is paid on the money borrowed.

The total amount that has been financed by the most active players in the P2P lending in Singapore is still negligible compared to the total debt/invoice financing market, though some of the companies have reached a monthly financing volume of several million Singapore dollars. Further, very few players publish their total loan book statistics. Capital Springboard claims to have financed around S$160 million, Capital Match S$44 million, Invoice Interchange S$17 million and Validus S$22 million. These amounts are commendable for startups, but cannot be compared to the overall funding market that is estimated by the MAS at S$633 billion (comprising total loans and advances to non-bank customers) in May 2017.

Senior bank debt and capital markets funding

SENIOR BANK DEBT
Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Singapore has both debt and equity capital markets which are accessible to businesses of certain size. Raising funds by way of an initial public offering (IPO) is therefore a popular funding arrangement for FinTech companies that have grown to a certain size.

In 2015, CoAssets listed its shares on the Australian Securities Exchange (ASX) in a deal that represented the first IPO of a Singapore grown P2P lender. Ayondo, a FinTech firm specializing in financial trading technologies, is planning a listing on the Singapore Exchange (SGX) in 2017. Upon its completion, the company will be the first FinTech company to be listed on the SGX.

CONVERTIBLE BONDS/LOAN NOTES

FinTech companies may issue bonds as a way of raising more competitive funding. A popular funding tool for fast growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

Incentives and reliefs

The regulatory sandbox (as described in FinTech products and uses – particular rules) is a key factor in attracting FinTechs to Singapore. Beyond the regulatory sandbox, there are other tax incentives promoting innovation, research and development and intellectual property management. These incentives also seek to attract new technologies into Singapore.

One of the schemes is the Productivity and Innovation Credit (PIC) scheme which was introduced in Budget 2010. Under the PIC scheme, qualifying businesses may enjoy up to 400% tax deductions/allowances for qualifying expenditure incurred in any of the six qualifying activities (such as research and development or acquisition of PIC IT equipment,) from 2011 to 2018. The concern is that with the phasing out of the PIC scheme in 2018, this could have an adverse effect on the momentum of innovation developed in Singapore over the past few years.

The MAS has also organized a return of the FinTech Festival in November 2017 and launched a new FinTech and Innovation Group within the MAS to provide information and advice to FinTech entrepreneurs.

Finally, the MAS has committed S$225 million over the next five years under the Financial Sector Technology and Innovation scheme (FSTI) to attract FinTech firms to set up innovation centers in Singapore. The FSTI scheme also has a ‘Proof of Concept Scheme’ which provides support to both financial and non-financial institutes in early stage development of innovative projects.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party’s rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.
What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **Confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **Data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **Lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **Undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **Transfer mechanics** – whether there are any steps and formalities that need to be taken to transfer the loan in accordance with its terms; and
- **Consent** – whether a transfer requires the consent or notification of any other parties.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

**Generally**

Steady progress has been made in Singapore over the last few years in terms of privatization. Significantly, there has been a big leap in energy sector privatization. Notably, in recent years, there has been a rise of public-private partnership (PPP) projects, which involve collaboration between various types of private sector companies and the public agency.

**Energy**

Since 1995, the power system assets have been structured to facilitate commercialization and subsequent privatization. As at the end of December 2008, the Singapore Government's investment arm, Temasek Holdings (Private) Limited, had divested Singapore’s three main power generating companies, representing a big part of the transition towards a fully liberalized power market in Singapore.

The Energy Market Authority (EMA) was established in 2001 as part of the government’s efforts to liberalize the electricity market. As a regulator, the EMA also ensures a reliable and secure energy supply and promotes effective competition.

**Telecoms infrastructure**
The telecommunications networks (fixed and mobile) are all privately owned.

In January 2000, the Singapore Government decided to advance the introduction of full market competition in the telecommunications sector.

**Transport infrastructure**

Singapore currently adopts a privatized approach for transport infrastructure. Singapore's land transport authority, the Land Transport Authority (LTA), regulates and oversees all three main modes of public transport in Singapore, ie taxis, buses and trains, and ensures that they meet safety and service standards. However, the day-to-day operations of running the MRT train systems, bus systems and taxi services are the responsibility of private operators.

The day-to-day operations of running the MRT train systems are the responsibility of two main public transport operators in Singapore, SMRT Trains Ltd and SBS Transit. These operators are responsible for the daily operations of trains and their maintenance. The main bus operators in Singapore include SBS Transit Ltd, SMRT Buses Ltd, Tower Transit Singapore and Go-Ahead Singapore. Bus operations are regulated by the Public Transport Council (PTC). There are currently seven taxi operators in Singapore, which are regulated by the LTA.

**Other infrastructure**

While most of the attention has been focused on privatization in the energy markets, the water and waste industries have also made significant progress in reaching out to the private sector for progress. For example, design, build, finance and operate (DBFO) desalination and NEWater projects have formed the backbone of the Public Utilities Board's (PUB) existing procurement strategy for private sector participation in new capital works.

*Are there special rules for investing in energy and infrastructure?*

**Generally**

There is no specific regime governing or restricting investment in energy or infrastructure projects in Singapore over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses.

**Energy**

Under the Electricity Act and the Gas Act, no person is permitted to supply or engage in activities related to the supply of electricity or gas respectively in Singapore without the appropriate license to do so issued by the Energy Market Authority (EMA).

Certain types of licenses issued by EMA may be subject to controls and restrictions on the ownership or transfer of shares in the licensees.

The EMA may designate any electricity licensee (DEL) or any entity (DE) or any business trust (DBT) operated by such licensee to be subject to additional restrictions. In particular, prior written approval of the EMA is required for:

- the appointment of chief executive officer, director or chairman of any DEL; and
- any person to acquire the business of a DEL or a DE as a going concern, or certain prescribed levels/forms of control over a DEL, DE or DBT.

**Telecoms infrastructure**

Although the Singapore telecommunication services market has been fully liberalized since 1 April 2000, pursuant to the Telecommunications Act, any person operating and providing telecommunication systems and services in Singapore has to be licensed by the Info-communications Development Authority of Singapore (IDA). Further, although there are no foreign equity limits or restrictions...
imposed on licensees, any such licensee must be a company incorporated in Singapore.

The IDA may designate any telecommunication licensee (DTL) or any trust (DT) or any business trust (DBT) operated by such licensee to be subject to additional restrictions. In particular, prior written approval of the IDA is required for:

- the appointment of chief executive officer, director or chairman of any DTL; and
- any person to acquire any part of the business as a going concern, or certain prescribed levels/forms of control over a DTL, DT or DBT.

**Transport infrastructure**

Under the Bus Services Industry Act 2015, any person operating a bus service in Singapore has to be licensed by the Land Transport Authority (LTA), or otherwise authorized to do so by contract with the LTA. Similarly, any person operating a rapid transit system in Singapore has to be licensed by the LTA. There are no express foreign equity restrictions imposed on such licensees.

With effect from 2016, Singapore will adopt a new contracting model which will enable the Singapore Government to make public bus services more responsive to changes in ridership. Under this model, LTA will determine the bus services to be provided and the service standards, and bus operators will bid for the right to operate these services.

**Other infrastructure**

Singapore is generally an open economy with minimal foreign ownership or investment restrictions. However, there is legislation relating to particular industries which limits or requires prior regulatory approval for share ownership in companies engaged in those industries. Those industries are generally industries perceived to be critical to national interest, such as banking, insurance and media.

Additionally, the Competition Act prohibits certain business practices that restrict competition in the market and prohibits mergers and acquisitions that substantially, or may be expected to substantially, lessen competition within the Singapore market.

**What is the applicable procurement process?**

In general, competitive bidding is the preferred procurement procedure of multilateral agencies. Public bidding processes have several advantages for host governments. A bid process increases competition among potential providers of the goods or services, minimizes the cost of the solicited good or service, and fosters public support and credibility for the project by ensuring that the process is transparent and thereby free of bribes and other corruption.

**Investing in energy and infrastructure**

The general procurement process would involve the following stages:

- refinement of appraisal;
- the Invitation to Tender (ITT);
- receipt and evaluation of bids;
- selection of preferred bidder and the final evaluation;
- contract award and financial close; and
- contract management.

**Financing energy and infrastructure**

The general procurement process would be similar.

**What are the most common forms of funding / investing in energy and infrastructure?**
The principal forms of private sector funding/investment in energy and infrastructure in Singapore (including in relation to public-private partnerships) are as follows.

**Funding**

Common forms of funding in energy and infrastructure include:

- public financing where the government uses funds from either tax revenue or public sector borrowing such as bonds;
- loans made on a corporate-finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing.

**Investing**

Common forms of investing in energy and infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of 'equity').

**Restructuring**

**Enforcement and sanctions**

*When can there be regulatory investigations?*

When the Monetary Authority of Singapore considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

*What regulatory penalties may apply?*

When a breach has taken place, the Monetary Authority of Singapore may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

*What criminal penalties may apply?*

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the money laundering regulations; and
Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Most security interests created by Singapore companies and Singapore limited liability partnerships must be registered at the Accounting and Corporate Regulatory Authority of Singapore to perfect the security and ensure it is valid against third parties. The grant of most security interests over Singapore real estate should be registered at the Singapore Land Authority to ensure that the security interest takes effect as a legal charge. Fees are payable for such registrations but it would be unusual for such fees to be of a material amount.

Other forms of registration may also be required (or be advisable), depending on the nature of the asset over which security is taken. Such registrations may also require the payment of fees.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

There is generally no charge to stamp duty, registration, transfer or other similar taxes on the issue, transfer or assignment of a debt security.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over the Inland Revenue Authority of Singapore on enforcement of security.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Withholding tax is applicable where a person is liable to pay another person (not known to such person to be resident in Singapore) any interest, commission, fee or any other payment in connection with any loan or indebtedness or in connection with any arrangement, management, guarantee, or service relating to any loan or indebtedness, if such payments are borne, directly or indirectly, by a person resident in Singapore or a Singapore permanent establishment of a person not resident in Singapore or if such payments are deductible against any income accruing in or derived from Singapore, unless exempted under applicable regulations.
If so:

What is the rate of withholding?

The applicable withholding tax rate for any interest, commission, fee or other payment in connection with any loan or indebtedness is 15%, if such income is derived by a person not resident in Singapore through operations carried on outside Singapore.

What are the key exemptions?

Payments made from 21 February 2014 onwards to a Singapore permanent establishment of a person not resident in Singapore, including Singapore branches of non-resident banks, are not subject to withholding tax.

Until 31 March 2021, specified entities such as banks licensed under the Banking Act or approved under the Monetary Authority of Singapore Act, finance companies licensed under the Finance Companies Act and certain other financial institutions do not need to withhold tax on any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness which is made to persons not resident in Singapore (and without a permanent establishment in Singapore), where the payments are made for the purposes of the trade or business of such specified entities.

In addition, if the person receiving the income is a resident of a country which has entered into a double tax treaty with Singapore, the applicable double tax treaty may provide for a reduced withholding tax rate or an exemption.

Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g., by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes.

Key contacts

Vincent Seah
Partner
DLA Piper Singapore Pte. Ltd.
vincent.seah@dlapiper.com
T: +65 6512 9595
Slovak Republic

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Slovak law and EU law.

Any securities, including debt securities can be traded on the stock exchange market only one day following the publication of the prospectus, or offered to the public only after an approved prospectus has been made available to the public.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Slovakia are bonds. You can mainly deal in the following types of bonds:

- state bonds;
- municipal bonds;
- employee bonds;
- subordinate bonds; and
- ensured bonds (bank bonds as a specific kind of ensured bonds).

Furthermore, treasury bonds are often issued by the state, usually via the National Bank of Slovakia. The maturity of the treasury bonds is typically shorter compared to government bonds, and cannot be longer than one year.

What are the differences between offering debt securities to institutional / professional or other investors?

The Slovak Securities Act makes no distinction between professional and other investors for the purposes of public offering of securities.

However, the obligation to publish a prospectus does not apply to an offer which is addressed solely to qualified investors (ie professional clients).
**When is it necessary to prepare a prospectus?**

Under the Slovak Securities Act the obligation to publish a prospectus shall apply to public offers of securities if the total value of each offer in the European Union, calculated over a period of 12 months, exceeds EUR1 million.

*Last modified 6 Dec 2019*

**What are the main exchanges available?**

The [Bratislava Stock Exchange](https://www.bse.sk) (Burza cenných papierov v Bratislave, a.s.) is the responsible authority for trading on regulated markets. Regulated markets are divided into the:

- Regulated Free Market; and
- Listed Securities Market.

The establishment and position of the Bratislava Stock Exchange in the process of trading of securities is governed by the [Stock Exchange Act](https://www.bse.sk). The Stock Exchange Act also regulates the operation and dissolution, the trading of securities and other financial instruments, and the supervision of the Bratislava Stock Exchange.

**The Regulated Free Market**

The Regulated Free Market is a stock exchange market. The traded securities and their issuers must meet the requirements provided under the [Stock Exchange Act](https://www.bse.sk). A security may be admitted to the Regulated Free Market only in the following circumstances:

- The security is a financial instrument.
- The security is a fungible security.
- The security's transferability is not limited.
- The security is a book-entry security.
- Securities issued by issuers located in another member state which permits the admission of definitive securities on the listed securities market may be admitted to the Regulated Free Market, provided that the Bratislava Stock Exchange discloses that the other member state permits the admission of definitive securities on its listed securities market.
- The security is issued in accordance with the law of the country where it was issued and the issuer complies with the applicable requirements for the issuance of securities under the laws of the country in which the issuer has its registered office.
- Bratislava Stock Exchange is not aware of facts which, if the security is admitted to trading on a regulated market, could cause damages for investors or pose a serious threat to their interests or be contrary to public interest.
- A prospectus has been approved and published, unless provided otherwise.
- The issue price of the security has been fully paid up.
- The security's subscription was successfully completed based on a public offer, or the period during which it was possible to receive applications for subscription of securities has lapsed (this does not apply to bonds which are issued continuously when the deadline for subscription is not fixed).
- Other requirements provided under the Act on Stock Exchange or a separate Act must also be considered.

**The Listed Securities Market**

The Listed Securities Market is a stock exchange market where the traded securities and their issuers meet the conditions provided under the Act on Stock Exchange described above, as well as separate conditions provided under the [Stock Exchange Act](https://www.bse.sk), depending on the type of security (bonds or shares).

A bond may be admitted to the Listed Securities Market only if the bond and its issuer satisfies the above stated conditions and the value of its issuance as determined by the issue price of the bonds is less than EUR200,000.
Is there a private placement market?

Slovakia does not have an active private placement market yet.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses, as well as for information provided in the documents promoting the issue of debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil liability for damages, as well as criminal liability.

Investing in debt securities

No specific issues.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing, operating and abolishing a fund are regulated by the Act on Collective Investment and subject to supervision of the National Bank of Slovakia.

Collective Investment

The regulations apply to activities undertaken in relation to collective investment which is a business activity comprising the following arrangements:

- collecting funds from investors in order to invest in accordance with a defined investment policy for the benefit of those persons from whom funds were collected;
- if the funds are collected from the public, collective investment can be carried out only on the basis of risk spreading;
- collective investment can be carried out only by creating a domestic collective investment entity, or by collecting funds through the offering of securities or investing in a foreign collective investment entity.

What are common fund structures?

Common forms of funds include:

- open-end mutual funds/open-end foreign collective investment entities;
- close-end mutual funds/close-end foreign collective investment entities;
- standard funds (which comprise of mutual funds or investment funds with variable capital, for which funds are collected through public
offer and with the purpose of investing the funds collected in transferable securities and other liquid financial assets on the basis of risk spreading);

- special funds (which comprise of mutual funds or investment funds with variable capital, for which funds are collected through public or private offer); and

- alternative investment funds, which are further divided into public special funds and special funds for qualified investors.

What are the differences between offering fund securities to professional / institutional or other investors?

Raising funds on the basis of a public offer of securities or equity participation in the domestic investment funds with variable capital, provided these domestic investment funds are companies or cooperatives established in the Slovak Republic, is prohibited. Distribution of securities or equity participations in domestic investment funds with variable capital, provided these domestic investment funds are companies or cooperatives established in the Slovak Republic, can be carried out only by private offers and only addressed to professional investors.

Qualified Investors Fund

A Qualified Investors Fund is a special fund for qualified investors and domestic investment funds, which is a company or a cooperative established in the Slovak Republic. The establishment of a Qualified Investors Fund is not subject to licensing according to the Act on Collective Investment.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Establishment and operation of a fund, except for a Qualified Investors Fund, is a regulated activity under the Act on Collective Investment rules and is subject to licensing and supervision by the National Bank of Slovakia.

Investing in funds

No specific issues.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Generally in Slovakia, offering securities is either covered by the Act on Collective Investment or by the Act on Securities.

Undertakings for Collective Investments in Transferable Securities (UCITS)

In Slovakia, standard funds, which can be mutual funds or investment funds with variable capital, are considered UCITS. A management company which decides to distribute securities of the standard fund it manages in another member state, is required to notify its intention to the National Bank of Slovakia prior to the commencement of such activity.

Alternative Investment Funds (AIFs)

Under the Act on Collective Investment, which implemented the respective provisions of the Alternative Investment Fund Managers
**Are there any restrictions on managing a fund?**

Fund management in Slovakia is regulated under the Act on Collective Investment. Any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization, unless a statutory exemption applies.

Full registration with National Bank of Slovakia involves a significant authorization process – three-to-six months from completion of the application, which must include information on personnel and organizational prerequisites for operation, internal policies and procedures, etc.

Subject to the requirements provided under the Act on Collective Investment, a company who wishes to manage alternative investment funds may be exempted from the full licensing process. Such exemption applies for instance in case of a person, who directly or indirectly through a company to which the person is personally linked or in a controlling relationship, manages portfolios of alternative investment funds, the total value of which is:

- under EUR100 million including assets acquired through leverage; or
- under EUR500 million where assets are not leveraged and investors have no redemption rights for five years.

In such case, the manager of investment fund must still be registered with the National Bank of Slovakia.

**Enter into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in Slovakia (such as a financial agent) will ordinarily have to be authorized under the Act on Financial Intermediation and Financial Advisory Services.

This applies:

- if the transaction is one of the specified activities within the provision of financial intermediation as set out in Section 2 of the Act on Financial Intermediation and Financial Advisory Services; or
- in case of securities dealer which will ordinarily have to be authorized under the Act on Securities and Investment Services if the transaction is one of the specified activities within the provision of investment services as set out in in Section 6 of the Act on Securities and Investment Services.

Both financial intermediation and provision of investment services include activities such as:

- forwards;
- futures;
- swaps; and
- options.

The European Market Infrastructure Regulation applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and
variation margin requirements.

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**What are common types of derivatives?**

Pursuant to the [Act on Securities and Investment Services](#), all of the following main types of derivative contracts are recognized under Slovak law:

- forwards;
- futures;
- swaps; and
- options.

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying assets in Slovakia are:

- securities;
- interest rates;
- exchange rate indices of funds held in euros or a foreign currency;
- securities contracts; and
- commodities.

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**Are there any other notable risks or issues around entering into derivatives contracts?**

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought in particular to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reclearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

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**Debt finance**

**Lending and borrowing**

**Are there any restrictions on lending and borrowing?**

In general, lending and borrowing in Slovakia are regulated by the [Civil Code](#) (which regulates loans) and by the [Commercial Code](#) which regulates credits). Special regulation may apply with respect to special types of loans or credits, such as, for instance, consumer credits.

**Lending**

Provision of loans or credits does not fall under the supervision of the [National Bank of Slovakia](#), unless a loan or credit comes from
financial resources acquired from third persons on the basis of a public call. In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the National Bank of Slovakia to conduct such business.

Public call means any announcement, offer or recommendation made by any person to collect funds for their own benefit or the benefit of a third party done by any means of publication, including personal contact with several persons, whether with individual persons or simultaneously with multiple parties. An announcement, offer or recommendation made solely through personal contact and to no more than ten persons is not considered a public call.

Housing loans provided to consumers are regulated by the Act on Housing Loans which regulates the information that needs to be provided to the consumer before the conclusion of the contract for a housing loan, the process of credit assessment, the consequences of breaching the obligations of the parties, as well as the obligations of financial agents and financial advisors.

Consumer loans and credits

Consumer loans and credits are subject to the requirements provided in the Act on Consumer Credits and Other Credits and Loans for Consumers which sets the requirements for:

- the information that needs to be provided to the consumer before the conclusion of the contract for a housing loan;
- the information that may be used in advertising consumer loans and credits;
- the process of credit assessment;
- the obligations of the creditors, as well as the information contained in the list of creditors which is maintained by the National Bank of Slovakia;
- the form and content requirements applicable to consumer credit contracts and the consequences of non-compliance;
- the mechanism for calculation of the annual percentage rate; and
- the obligations of the financial agents and financial advisors.

Mortgage loans and municipal loans

Housing loans are loans provided only to consumers for the purposes of purchasing residential property. Mortgage loans are generally provided on the basis of the Act on Banks and may be granted to any party (provided that the conditions stipulated in the Act on Banks are fulfilled). However, a mortgage loan will still be considered a housing loan if provided to consumers for the purposes of purchasing residential property.

Mortgage loans and municipal loans are regulated by the Act on Banks and are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular requirements for:

- the maturity period;
- the purposes of such mortgage contract; and
- the financing of such mortgage contract.

According to the Act on Banks, a bank may not provide a loan or guarantee liabilities under a loan for:

- any acquisition of shares it issued;
- any acquisition of shares issued by a person who holds a qualified interest in the bank;
- any acquisition of shares issued by legal persons who control or are controlled by persons holding a qualified interest in the bank;
- any acquisition of shares issued by legal persons controlled by the bank; and
- the repayment of another loan granted for any of the above acquisitions of shares or to guarantee liabilities under such a loan.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending
What are common lending structures?

Lending in Slovakia can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or a syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents who fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicates taking the lead in coordinating and arranging the financing.

Loans can be structured to achieve specific objectives, e.g. bank overdraft, discount credit, consumer loan, acceptance credit, loan against securities, bridging loan etc.

Loan durations

The loans may be divided on the basis of their duration into:

- short- and medium-term loans, such as discount credits, consumer loans or acceptance credits; and
- long-term loans, such as mortgages, municipal credits or consumer housing loans.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or on a scheduled basis (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

In general, lending to institutional/professional borrowers is subject to less regulatory oversight and is consequently less burdensome from a compliance perspective.

Lending in the context of mortgages and lending to consumers is a regulated activity and requires authorization from the National Bank of Slovakia.

Do the laws recognize the principles of agency and trusts?
Slovak law recognizes the principle of agency. For instance, it is possible to appoint an agent to act on behalf of other parties. Financial agents are listed in the Register of Financial Agents and Financial Advisors maintained by the National Bank of Slovakia.

Slovak law does not recognize the principle of trust, so it is not possible to appoint a trustee to hold rights and other assets on trust for the lenders or secured parties.

**Are there any other notable risks or issues around lending?**

**Generally**

Loan agreements and other finance documents are subject to general contractual principles. For example, the Slovak courts will not enforce a penalty that does not correspond to the amount of the loan. Lenders therefore, have to be careful about the rate of default interest charged on a loan.

**Specific types of lending**

Specific to the area of mortgage lending is the issue of whether a lender falls within the recently formed Slovak housing loans regime. The Mortgage Credit Directive, implemented in Slovakia mainly through the Act on Housing Loans and a series of primary and secondary legislation, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis.

The Mortgage Credit Directive applies to first and second charge mortgages. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

**Company in crisis**

Pursuant to the Commercial Code a company is considered ‘in crisis’ if it is:

- bankrupt (i.e. insolvent or in default); or
- under the threat of bankruptcy (i.e. the ratio of its equity to liabilities is less than the statutory limit ratio of 8:100).

A creditor who grants a loan to a company ‘in crisis’ or until the declaration of bankruptcy or the restructuring permit, may not be able to recover (some or) the full amount of the loan if it was aware of the company’s financial position at the time the loan was granted.

**Standard form documentation**

Bilateral finance transactions are typically documented on bank standard form documentation prepared in-house.

**Are there any other notable risks or issues around borrowing?**

Borrowers should be aware of the potential implications of the EU’s Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions. The BRRD has been implemented mainly by the Act on Resolution in the Financial Market.

This regulative framework is applicable to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

The Act on Resolution in the Financial Market which has, among others, implemented also the Article 55 of the BRRD, gives authorities the power to ‘bail in’ obligations of failed EEA financial institutions. Institutions to whom the resolution applies shall include a contractual term
in any agreement creating a liability. The creditor or party to the agreement recognizes that the liability may be subject to write-down or conversion, and agrees to be bound by any reduction in the principal or outstanding amount due, or conversion or cancellation that is effected by the exercise of the write-down or conversion power by the resolution authority, provided that such liability is:

- not excluded;
- not a deposit under Slovak law;
- governed by the law of third country; and
- entered into or changed after the date on which the Act on Resolution in the Financial Market became effective (this does not apply to a change of obligation, including an automatic change, that does not affect the fundamental rights and responsibilities of the party of this obligation).

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to confirm whether it is duly established, and whether a separate resolution of the shareholders is not required in order to duly provide such guarantee or security. The safe approach is often to have the shareholders of the company approve the giving of the guarantee or security by resolution. Furthermore, it is necessary to ensure that the directors of the company act on behalf of the company in compliance with the way of acting prescribed by the constitutional documents and way of acting registered in the Commercial Register.

Insolvency

Guarantees and security may be at risk of being contested in bankruptcy proceedings, if the guarantee or security was granted by a company without adequate consideration, caused the debtor's bankruptcy or made during the debtor's bankruptcy and granted during one year prior to the initiation of bankruptcy proceedings. If it is a legal act without adequate consideration made in favor of a party related to the debtor, it is also possible to contest the guarantee or security made during the three years prior to the initiation of bankruptcy proceedings.

What are common types of guarantees and security?

Guarantees

In general, by providing a guarantee, the guarantor undertakes that it will fulfil the obligation of the debtor (as a whole or part), in case the debtor fails to duly perform its obligation. The law does not differentiate between the performance of payment obligations or any other kind of obligation. Therefore, the guarantee may also be granted in order to secure the obligation of the debtor to provide services etc.

Common forms of security

Basic types of security that can be created under Slovak law include:

- pledges;
- secured transfer of a right; and
- bills.
Under Slovak law it is possible to grant security over all of the assets of a company or individual assets. Granting security will tend to be achieved by way of:

- pledge over a business share;
- pledge over the real estate;
- pledge over the receivables or over accounts receivables;
- a pledge over assets which are identifiable and can be controlled by the creditors (such as equipment); or
- secured transfer of right to the real estate.

**Are there any other notable risks or issues around giving and taking guarantees and security?**

**Giving or taking guarantees**

To be valid, a guarantee has to be granted in writing. A guarantee may be provided with or without consideration.

If several guarantors secure the same obligation, each of them is liable for the entire obligation. In case one of the guarantors fulfils the obligation, it has the right to recourse towards the other guarantors.

The guarantee does not expire if:

- the obligation expired due to the debtor's inability to fulfil it and the obligation may be fulfilled by the guarantor; or
- due to the dissolution of the legal entity that is the debtor.

**Giving or taking security**

Depending on the type of security, security may have to be granted in writing and notarization may be required.

Once granted, security in the form of a pledge needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the pledge in the notarial register of pledges or in the Commercial register and notice being given to third parties.

Like guarantees, a pledge may be at risk of being contested in bankruptcy proceedings, if the security was granted by a company without adequate consideration, caused the debtor's bankruptcy or was made during the debtor's bankruptcy and was granted during the one year period prior to the initiation of bankruptcy proceedings.

**Financial regulation**

**Law and regulation**

**What are the main laws and regulations that apply to entities that are involved in finance and investments generally?**

**Generally**

Act No. 186/2009 Coll. on Financial Intermediation and Financial Advisory Services, as amended (Zákon o finannom sprostredkovani a finannom poradenstve a o zmene a doplnení niektorých zákonov) (regulating mainly financial intermediation and financial counselling)
Act No. 747/2004 Coll. on Supervision of the Financial Market, as amended (Zákon o dohade nad finančným trhom a o zmene a doplnení niektorých zákonov) (regulating the supervision of the financial markets as exercised by the National Bank of Slovakia)

Act No. 483/2001 Coll. on Banks, as amended (Zákon o bankách a o zmene a doplnení niektorých zákonov) (regulating the establishment, organization, management, business operations, and termination of banks)

Act No. 566/2001 Coll. on Securities and Investment Services, as amended (Zákon o cenných papieroch a investiných službách a o zmene a doplnení niektorých zákonov) (regulating mainly securities and investment services)

Act No. 429/2002 Coll. on Stock Exchange, as amended (Zákon o burze cenných papierov) (regulating the stock exchange)

Act No. 492/2009 Coll. on Payment Services, as amended (Zákon o platobných službách a o zmene a doplnení niektorých zákonov) (regulating the payment services and establishment and operation of payment systems, payment institutions and electronic money institutions)

Act No. 530/1990 Coll. on Bonds, as amended (Zákon o dlhopisoch) (regulating bonds)

Act No. 202/1995 Coll. the Foreign Exchange Act, as amended (Devízový zákon) (regulating trading in foreign exchange assets, foreign exchange authorities and foreign exchange supervision)

Act No. 566/1992 Coll. on National Bank of Slovakia, as amended (Zákon o Národnej banke Slovenska) (regulating the activities of the National Bank of Slovakia)

Act No. 118/1996 Coll. on Deposit Protection, as amended (Zákon o ochrane vkladov a o zmene a doplnení niektorých zákonov) (regulating the protection of deposits held in accounts with banks and branches of foreign banks)

Act No. 371/2014 Coll. on Resolution in the Financial Market, as amended (Zákon o riešení krízových situácií na finančnom trhu a o zmene a doplnení niektorých zákonov) (regulating the procedure to be followed in connection with resolution in the financial market of the Slovak Republic)

Act No. 343/2015 Coll. on Public Procurement, as amended (Zákon o verejnom obstarávaní a o zmene a doplnení niektorých zákonov) (regulating procurement processes in Slovak Republic)

Act No. 18/2018 Coll. on Protection of Personal Data and on amending and supplementing of certain acts (Zákon o ochrane osobných údajov a o zmene a doplnení niektorých zákonov) (regulating processing of personal data in Slovak Republic)

**Consumer credit**

Act No. 129/2010 Coll. on Consumer Credits and Other Credits and Loans for Consumers, as amended (Zákon o spotrebiteľských úveroch a o iných úveroch a pôžiškach pre spotrebičov a o zmene a doplnení niektorých zákonov) (regulating the provision of consumer credits)

Act No. 250/2007 Coll. on Consumer Protection, as amended (Zákon o ochrane spotrebičov) (regulating the rights of consumers and the obligations of producers, traders, importers and suppliers)

Act No. 40/1964 Coll. Civil Code, as amended (Obiansky zákonník) (regulating the property relations of natural persons and legal entities as well as property relations between such persons and the state)

**Mortgages**

Act No. 90/2016 Coll. on Housing Loans, as amended (Zákon o úveroch na bývanie a o zmene a doplnení niektorých zákonov) (regulating the provision of housing loans)

**Corporations**

Act No. 513/1991 Coll. Commercial Code, as amended (Obchodný zákonník) (regulating the status of entrepreneurs, commercial obligations and some other relations relating to entrepreneurial activity)

**Funds and platforms**

Act No. 43/2004 Coll. on Old-Age Pension Saving Scheme, as amended (Zákon o starobnom dôchodkovom sporeni a o zmene a doplnení
niektorých zákonov) (regulating the scope and financing of old-age pension scheme)

Act No. 650/2004 Coll. on Supplementary Pension Scheme, as amended (Zákon o doplnkovom dôchodkovom sporení a o zmene a doplnení niektorých zákonov) (regulating the supplementary pension scheme and the transformation of supplementary pension insurance companies)

Investment funds

Act No. 203/2011 Coll. on Collective Investment, as amended (Zákon o kolektívnom investovaní) (regulating the rules of collective investment)

Other key market legislation

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)

Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)

Regulatory authorization

Who are the regulators?

The National Bank of Slovakia is responsible for the supervision of the financial markets.

The supervisory tasks of the National Bank of Slovakia include:

- laying down prudential business rules and other requirements in relation to the business activities undertaken by supervised entities;
- monitoring compliance with the relevant laws and regulations of Slovakia, as well as with legal acts of the EU;
- conducting proceedings, issuing authorizations, licenses, permissions and approvals, and imposing sanctions and remedial measures;
- issuing other decisions, opinions, methodological guidelines and recommendations relating to financial markets supervision;
- conducting on-site and off-site supervision of supervised entities; and
- preventing the legalization of proceeds of criminal activity and financing of terrorism.

What are the authorization requirements and process?

Relevant firms must apply to the National Bank of Slovakia for authorization.

The regulator must assess whether the application meets the required threshold conditions. In the case of issuance of a banking license, the regulator must complete the assessment within six months of the submission of the complete application.

The application fee depends on the type of the application ranging from EUR40 to EUR5,000.

The regulator will also approve key individuals (e.g. senior management) in their roles.

Authorized firms and individuals are listed in a number of different registers (e.g. Register of Alternative Investment Fund Managers) maintained by the National Bank of Slovakia.

What are the main ongoing compliance requirements?
Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and the more detailed regulatory rules can result in sanctions for firms and regulated individuals, and even result in a loss of regulated status.

Legal entities undertaking a regulated activity without being authorized or exempt may also be subject to various monetary and non-monetary sanctions issued by the National Bank of Slovakia.

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**What are the penalties for failure to be authorized?**

A natural person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment.

Pursuant to the Act on Criminal Liability of Legal Entities, a legal entity may also be held liable for undertaking a regulated activity without being authorized or exempt. In this case, the sanctions for such conduct may include winding-up of the legal person, forfeiture of property, pecuniary penalties, prohibition to undertake certain activities or disclosure of the court decision.

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**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

A person must not carry on a regulated activity in Slovakia unless authorized or exempt.

Activities supervised by the National Bank of Slovakia require authorization. As part of its supervision of the financial markets, the National Bank of Slovakia is responsible for the supervision of legal entities and natural persons charged with obligations under the laws of Slovakia in the area of banking, capital markets, insurance business, pension insurance or pension schemes, as well as with the supervision of the property associations with a designated purpose and groups of persons and property associations with a designated purpose charged with the same obligations as stated above.

**Consumer credit**

Pursuant to the Slovak Act on Consumer Credits and Other Credits and Loans for Consumers a creditor is only entitled to provide consumer credit if it has been authorized to do so by the National Bank of Slovakia.

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**Are there any possible exemptions?**

The available exemptions relate to the nature of the agreement, the lender and the borrower, the number of repayments to be made and the total charge for credit. In case of consumer credit exemptions do not apply, according to the Slovak Act on Consumer Credits and Other Credits and Loans for Consumers, no one shall, in the course of his business, offer or provide consumer loans without authorization or beyond the scope of the authorization of banking licence or other authorization to carry out banking activities.

There are two types of exclusions available when regulated activities may be undertaken without authorization from National bank of Slovakia, as follows:

**General exclusions**
Certain persons may carry on a regulated activity without being authorized. In certain cases regulated activities carried on by overseas persons may be undertaken without authorization. For example, exercising passporting rights allows firms, provided they are authorized to provide financial services in one jurisdiction, to provide such services in another jurisdiction without the need for authorization in this host jurisdiction.

Specific exclusions

For each type of regulated activity there are a number of specific exemptions that could also apply. For instance persons that provide investment services exclusively for their parent undertakings, for their subsidiaries or for the subsidiaries of their parent undertakings do not require authorization.

Do any exchange controls or other restrictions on payments apply?

Slovakia does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in and out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

There may also be anti-money laundering and tax considerations to take into account.

What are the rules around financial promotions?

A financial promotion is a communication of an invitation or inducement to engage in investment activity made by a person in the course of business.

An investment firm and a bank authorized by the National Bank of Slovakia may use bound investment agents for the promotion of investment services and secondary services, provided that the bound investment agent is registered in the relevant register.

A bound investment agent may perform financial intermediation only for one financial institution.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities used to undertake financial or investment activity are joint stock companies, which are body corporates with separate legal personality.

A joint-stock company has registered capital which is divided into shares with a specified nominal value. It can have any number of shareholders. A joint-stock company is liable for the breach of its obligations with its entire property and therefore its liability is limited to the value of this property. The shareholders are not liable for the obligations of the company. However, each shareholder is liable to the company for the issue rate of the subscribed shares. Some activities require a particular type of legal entity to be used. For example, pursuant to the Slovak Act on Banks, banks may only be incorporated in the form of a joint stock company.

The list of shareholders is available at the Central Securities Depository. Joint-stock companies can be either public or private. A public joint-stock company has all or part of its shares accepted for trading on a regulated market in the European Economic Area. Joint-stock
companies can have a sole corporate shareholder (not a natural person) or at least two shareholders (who are natural persons). The company must execute a memorandum of association (or founding deed, where there is a sole shareholder), which includes the company’s articles of association.

**Funds**

Pursuant to the Act on Collective investment, investment funds are most commonly set up as joint-stock companies although for certain types of investment funds, such as collective investment undertakings, other types of corporate entities may be used.

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**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes.

A company can conduct lending or investment business in Slovakia through an establishment (also known as a ‘branch’) but this does not create a separate legal entity.

The branch office of a foreign company does not have a separate legal personality from its parent company, but has its own management (director of a branch), accounting and tax requirements. It must be registered in the Slovak Commercial Registry, although liability for the operations of the branch remains with the parent.

Overseas companies carrying on a trade in Slovakia through a ‘permanent establishment’ will be subject to Slovak corporation tax.

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**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Peer-to-peer funding platforms and marketplace lending**

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.
Recently, peer-to-peer (P2P) products in Slovakia have included:

- (non-regulated) consumer loans;
- loans in order to pay down payments for property mortgages; and
- lending to SMEs.

**How are marketplace lending platforms funding themselves?**

Marketplace lending includes P2P-type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. Funding platforms are mostly backed by individual investors but financial institutions are also starting to invest in the platforms (mainly in the case of crowdfunding).

**Blockchain, smart contracts and cryptocurrencies**

**What is blockchain?**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (e.g. in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**What are smart contracts and decentralized autonomous organizations (Daos)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which
automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Banking Authority definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority, nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, stored or traded electronically. The European Central Bank (ECB) defines a cryptocurrency (or virtual currency) as a “type of unregulated, digital money, which is issued and usually controlled by its developers, and used and accepted among the members of a specific virtual community”. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICO is a popular method of raising funds primarily for startups (even though in Slovakia their use is rather limited). ICOs come in a wide variety of forms and may be used for a wide range of purposes. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal in Slovakia and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security, or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- a prospective return on investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of the underlying technology;
- quantity of coins or tokens that are reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

Artificial intelligence and robo advisory systems
Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact the banking and private wealth advisor sectors. Robo advisors are one of many ways that minimize human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

DATA ANALYSIS

Data analysis is a process through which data can be inspected, transformed or modeled with the goal of discovering new information and providing an ability to draw conclusions. Data analysis is usually directed to improve the process of decision-making, although there are multiple approaches and diverse techniques, each under a variety of names, that can be used to analyze data.

CLOUD COMPUTING

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data on remote servers (privately-owned cloud, or a third-party server), accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years. Use of third-party clouds allows companies to focus on their business without the need to invest as much as they otherwise would in their own IT infrastructure.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

National Bank of Slovakia is the main regulatory body for the financial market as a whole, including both retail and wholesale markets.

GENERAL

In general, a person cannot carry on a regulated activity in the Slovak financial sector without being regulated by the National Bank of Slovakia. Therefore, there is a need for specific authorization where a particular activity carried out as a business in Slovakia may or may not fall under the regulation. This mostly applies to activities of traditional financial market institutions, as most FinTech services and innovations currently do not fall under the regulatory power of the National Bank of Slovakia.

STATEMENT OF THE NATIONAL BANK OF SLOVAKIA ON FINTECH SERVICES

On 27 April 2016, the National Bank of Slovakia warned against the use of peer-to-peer (P2P) or crowdfunding methods for providing loans, as these types of contracts, as well the entities providing them, currently do not fall under its regulatory competence.

On 8 April 2019, the National Bank of Slovakia, in cooperation with the Ministry of Finance of the Slovak Republic launched, an innovative hub. It aims to support the implementation of modern technologies in the Slovak financial market and to improve the rules of their functioning.

The innovative hub is designed for those, with a real business plan, interested in the FinTech area. Thanks to the innovative hub, interested parties can have a dialogue with National Bank of Slovakia experts who will help them understand the details of business requirements in the financial market. In order to establish communication with the National Bank of Slovakia, a contact form has been created to enable the National Bank of Slovakia to obtain a basic overview of the intention of the FinTech applicant. "The innovation hub will provide those interested in doing business in this area with information about the ecosystem of innovative business models and help them navigate the relevant regulatory requirements," explained the Executive Director for Financial Consumer Regulation and Protection from National Bank of Slovakia.
Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENTS PLATFORMS

In recent years, many innovative payment solutions have been introduced to the Slovak market, such as contactless payments (introduced by VISA and MasterCard in alliance with the mainstream banks) and increasingly popular mobile payments. One of the most used and popular applications for mobile payments in Slovakia is VIAMO, which enables money transfers to a mobile phone number, without knowing the actual account details of the receiver.

With respect to the electronic money (e-money) institutions, such institutions need to be granted authorization by the National Bank of Slovakia in order to handle e-money and perform payment transactions related thereto. E-money is money that is exchanged exclusively electronically. E-money transfers (EFT), credit or debit cards are all examples of e-money.

PEER-TO-PEER LENDING REGULATION

Currently, P2P lending is not regulated in Slovakia and therefore does not fall within the regulatory competence of the National Bank of Slovakia.

Regulation of payment services

In order to provide payment services and to issue and manage e-money in Slovakia, it is necessary to obtain an authorization which is granted by the National Bank of Slovakia pursuant to Act No. 492/2009 Coll. on payment services. Failure to provide services without a respective license is a criminal offence.

To become authorized by the National Bank of Slovakia, a payment services business or business wishing to issue and manage e-money will need to meet certain criteria, including initial capital, functional procedures for safeguarding of the financial funds, adequate, appropriate organizational prerequisites for conducting the services, etc. One notable provider of payment services in the Slovak FinTech sector is a payment gateway called TrustPay.

Application of data protection and consumer laws

Slovak Republic reflected adoption of the European General Data Protection Regulation (GDPR) in Act No. 18/2018 Coll. on Protection of Personal Data and on amending and supplementing of certain acts (Data Protection Act). The Data Protection Act became effective as of 25 May 2018. The Data Protection Act repealed the previous Act No. 122/2013 Coll. on protection of personal data. The Data Protection Act regulates the processing of personal data within Slovakia. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the Data Protection Act and certain notification and compliance obligations will apply. In addition to the above, Act No. 351/2011 Coll. on electronic communications, as amended regulates unsolicited direct marketing by electronic means. Furthermore, Act No. 250/2007 Coll. on consumer protection, as amended and Act No. 266/2005 Coll. on the consumer protection at distance financial services, as amended shall apply as well, as they provide general legislative regulations relating to consumer protection.

Nowadays, GDPR alongside with the Data Protection Act are regulating processing of personal data in Slovak Republic.

Money laundering regulations

The basic legislative framework is primarily determined by Act No. 297/2008 Coll. on protection against legalization of proceeds from crime and on protection against financing of terrorism, as amended (AML Act). The AML Act empowers the National Bank of Slovakia to supervise and control fulfilment of anti-money laundering obligations by the entities that fall into its regulatory competence (i.e. in particular, businesses offering services such as lending, payment services and issuing and administering other means of payment). The National Bank of Slovakia also actively cooperates with the Financial Intelligence Unit (a central national police unit specializing in the prevention and detection of money laundering and terrorist financing), in order to enforce the AML Act.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage
SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector is not yet well established in Slovakia, however there have been other projects which have been successfully funded through crowdfunding. Therefore, in the future this may be an appropriate source of funding for a FinTech business in its early stages. Crowdfunding involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdberry or Conda.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

Accelerators are currently not a common way of offering support, facilities and funding for startups in Slovakia, even though an international incubator/accelerator for startups, RubixLab, is present in Slovakia. Slovak startups usually take part in the programs of foreign accelerators, such as Ycombinator or Blackbox (e.g. M.Dot – a startup that allows users to create web pages through their mobile phones – took part in Blackbox and was subsequently acquired by GoDaddy).

Even though it seemed that real estate project Binarium (created by the co-founder of IT security company ESET, Miroslav Trnka) could have become a Slovak accelerator, currently this is not the case and it serves more as a co-working space. Nevertheless, Binarium could in the future offer its tenants (mostly businesses in the technology sector) the possibility to attend professional events targeted at the community of IT specialists and technologists. However (at least so far), Binarium does not plan to provide the targeted mentoring programs nor financial investment that would normally be provided by startup accelerators.

Venture capital and debt

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions. In Slovakia, examples of VC funds investing into FinTech startups and technology startups more generally include Neulogy, G4 and LUKA & BRAMER GROUP.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund. Even though it is uncommon in Slovakia, one example of CVC is the acquisition of PoSam (a leading Slovak IT business) by Deutsche Telecom (DTAG) in 2010.

An additional funding option is venture debt, which is typically structured as a loan (or series of loans), secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through VC.

Warehouse and platform funding

Even though warehouse financing, as a form of inventory financing, may not be the best option for all FinTech companies, it remains a potential option to obtain financing for those companies that own a portfolio of assets.

Another alternative form of funding is through peer-to-peer (P2P) lending platforms such as Zlymelon.sk or ZincEuro.sk, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments;
interest is paid on the money borrowed instead.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdrafts, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

Although formally capital market funding is available in Slovakia, due to the fact that Slovakia itself is a small market and there is limited liquidity in the market, capital market funding is not a commonly used method of obtaining funding.

Even though it is possible to raise finance by way of an Initial Public Offering (IPO) on the Bratislava Stock Exchange, this is not a popular funding arrangement for companies. If a company grows to a certain size and considers an IPO, it usually reaches out to bigger and more active capital markets and stock exchanges in the region, such as those stock exchanges in Warsaw, Vienna or Prague.

Moreover, it is worth noting that over 95% of trades on the Bratislava Stock Exchange represent bond trades. Even though obtaining funding by way of issuing bonds to retail investors might be a reasonable option to raise more competitive funding, due to the costliness of the whole process it would not be a viable funding option for the vast majority of startups.

**Incentives and reliefs**

In order to encourage companies to invest in research and development (R&D), businesses that invest in R&D can, under the condition stipulated by Act No. 595/2003 Coll. on income tax, benefit from a 'super-deduction' of their R&D expenditure (costs) from their tax base.

*Last modified 6 Dec 2019*

**Portfolio sales**

**Loan transfers and portfolio sales**

*What are common ways of buying and selling loans?*

A loan can be transferred on an individual basis or packaged up with other loans and transferred as a portfolio.

The ways of transferring loans are:

- **Novation** – By means of novation, the existing contract (rights and obligation) is replaced with a new contract. Transfer of a loan to the third party should be concluded as a tripartite agreement between the existing parties and the transferee, whereas the rights and obligations of the transferor shall be transferred to the transferee.

- **Assignment of receivables** – An assignment of receivables constitutes a transfer of rights only, not obligations. Subject to any contractual restrictions, the assignment of receivables can be done without the consent of the debtor (but an assignor is obliged to notify the debtor, without undue delay, of the assignment of the receivables). Accessory rights and all other rights connected with the receivables shall be transferred together with the assigned receivables.

The form and content of the transfer documentation will depend on the nature of the loan which is being transferred. For complex transactions, a more bespoke form of transfer agreement shall be used.

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*What are the main considerations when transferring a loan and related security?*
There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise. Some of the key considerations include:

- **confidentiality** – whether the transferor of the loan is allowed to disclose information relating to the loan to a potential transferee;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential transferee;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred (e.g. in case of consumer credit loans, which can be provided only by a credit institution authorized by the National Bank of Slovakia);
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

Projects

Financing / investing in energy / infrastructure

*To what extent are energy and infrastructure assets publicly or privately owned?*

Generally

The ownership of energy and infrastructure assets in Slovakia varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

Energy

The gas and electricity industries in Slovakia are partially privatized, with the generation, distribution and supply services provided by a number of private sector companies. The relevant private sector companies own the generation and distribution assets.

The Regulatory Office for Network Industries, as the national regulation authority, performs its tasks pursuant to Act No. 250/2012 Coll. on regulation in network industries, as amended and determines the relevant prices and conditions of their application in network industries, as well as the conditions for the regulated activities performance. The Regulatory Office for Network Industries is a state authority which is independent from state authorities, municipal authorities, other public authorities or other persons. The Regulatory Office for Network Industries shall exercise its competence fairly and independently. Within its performance it is not subject to any political or business groups.

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in Slovakia are privately owned by a number of service providers.

The Regulatory Authority for Electronic Communications and Postal Services is the regulator for the telecommunications sector in Slovakia. It also regulates television broadcast services, wireless communications services as well as postal services.

Transport infrastructure

LIGHT RAIL
Typically, light rail assets (such as trams) are owned by respective local municipalities by way of designated local transport companies.

**HEAVY RAIL**

The heavy rail sector is mainly operated by the following three state-owned companies Železnice SR (ŽSR) – Slovak Railways, Železničná spolonoš Slovensko a.s. and Železničná spolonoš Cargo Slovakia a.s.

The rail sector is regulated by the Ministry of Transport and Construction of the Slovak Republic.

Furthermore, there are number of private companies such as RegioJet a.s. or Leo Express a.s. that operate railway passenger transport services in Slovakia. The arrival of a private railway carriers has started a competitive rivalry for the passengers between the private and state-owned carriers resulting in a general increase of standard of the railway transportation.

**ROADS, BRIDGES AND TUNNELS**

Národná diálná spolonoš a.s. (National Highway Company) is a joint-stock company that was established in 2005 and its sole shareholder is the Slovak Republic acting through the Ministry of Transport and Construction of the Slovak Republic. The main activities of the company include the building of highways and motorways, management and maintenance of motorways and highways and charging for the use of Slovak motorways and highways. The company operates in the territory of the Slovak Republic through its 15 management and maintenance centers.

A government entity, Slovak Road Administration, operates, maintains and improves the motorways and major first class roads (i.e. the strategic road network) in Slovakia. Slovak Road Administration is regulated by the Ministry of Transport and Construction of the Slovak Republic. Slovak Road Administration has its regional representation through organizational units deployed under a single name Investment Construction and Management of Roads, specifically in the following cities: Bratislava, Banská Bystrica, Žilina and Košice.

Local roads owned by the municipalities in Slovakia are the responsibility of local authorities (municipalities) or responsibility of legal entities established by the municipalities with the purpose of maintaining roads.

**AVIATION**

Aviation in Slovakia is (for the most part) privatized. With respect to the airport infrastructure, there are airports that are owned by the Slovak Republic as well as airports that have been privatized. Aviation in Slovakia is regulated by the Transport Authority and by the Ministry of transport and construction of the Slovak republic.

**THE TRANSPORT AUTHORITY**

The Transport Authority was established by the Act on Regulatory Authority for Electronic Communications and Postal Services and on Transport Authority in January 2014 as a state administrative body with nationwide competence in the area of railways and other guided transport, civil aviation and inland waterway transport. The Transport Authority undertakes activities in the area of railways and other guided transport, civil aviation and inland waterway transport, cooperates in the area of its competences with the Ministries and other state administration bodies, with the EU bodies as well as with a number of relevant international bodies. The Transport Authority is financed from the state budget. The Transport Authority is an independent body and state administration bodies, entities, authorities, nor any other persons may manipulate or interfere the activities of the Transport Authority.

**Other infrastructure**

**SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)**

Typically, these are mainly owned by the public sector and are regulated by the state authority depending on the type of social infrastructure. The majority of social infrastructure assets in the Slovak republic are directly financed by the government. Subject to value for money considerations, private finance may also be used in the procurement of social infrastructure assets.

**Education**

The ownership of a school’s infrastructure can be public or private. Schools of the Slovak Republic must be included in the network of schools and registered with the Central register of the schools maintained by Slovak Centre of Scientific and Technical Information which is governed by the Ministry of Education, Science, Research and Sport of the Slovak Republic.
Hospitals

Ownership of hospitals can be public or private, both types must hold a license for operating granted by the Ministry of Health of the Slovak Republic. The regulatory authority in this area is the Health Care Surveillance Authority.

DEFENSE

Typically, defense assets are state-owned.

WASTE

The Ministry of Environment is the relevant state authority responsible for setting goals with respect to the waste management in Slovak Republic in order to develop an appropriate approach for using materials in the area of cycle, recycle, devaluation and destruction of waste.

WATER

Water and wastewater (sewerage) services in Slovakia are delivered by private sector companies (water companies) which own the relevant infrastructure assets. In Slovakia, the ownership of public water and wastewater pipelines, can be only owned by legal entities with registered seat in the territory of Slovak Republic. The Regulatory Office for Network Industries is the relevant regulator of the water sector in Slovakia.

Are there special rules for investing in energy and infrastructure?

 Generally

In general, there is no specific regime governing or restricting investment in energy or infrastructure in Slovakia over and above existing regulation for investors and funders, however, a particular proposed investment may be subject to regulatory control. As regards the planning and implementation of the energy or infrastructure project, the legal/regulatory position relevant to that project must be considered (e.g. whether any permissions or consents of or licenses issued by the public authorities are required, etc). Key sector-specific issues are flagged in the sections below.

Whether an investor can invest in a public sector project will depend on the terms of the procurement of such project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on ‘Change of Control’. This is less of a concern on private sector infrastructure projects although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy market in Slovakia is heavily regulated. In particular, there is a complex regulatory framework regarding licensing, subsidies and demand/charging mechanism and these are subject to regular updates. Therefore, the investors need to have a good understanding of the current framework. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies.

Telecoms infrastructure

The Act on Electronic Communications regulates an environment for this sector, including access and interconnection between the networks, rights and obligations to third party real estate in connection with the establishment and operation of networks, as well as the competence of the state authorities to regulate the prices.

The industry is privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

Transport infrastructure
RAIL

There is an extensive and complex regulatory framework governed by the Act on Tracks and by the Act on Transport on Tracks, which also includes the conditions for acquiring a license for provision of transport services and which shall be taken into consideration in respect of involvement in this sector. Depending on how an investor wishes to invest in a project (specifically what type of entity or asset), there is a varying degree of difficulty for investors to enter into an existing project. Moreover, investors should consider if, depending on the way of investment, any permits/consents/licenses will be affected by their investment.

ROADS

The administration of the roads is, in accordance with Roads Act the responsibility of the state, municipalities or other public sector entities. The respective public sector entity is also responsible for carrying out the maintenance of the roads, however, such duties may be delegated to private sector partners, based on the respective procurement rules. With respect to the highways, the state may procure the construction of and future operation of the highways by a private sector partner under a concession contract awarded on the basis of the public procurement procedure. The precise scope of the restrictions (e.g. whether change of control is allowed) will depend on the contractual terms.

What is the applicable procurement process?

Public procurement in Slovakia is governed by the Act on Public Procurement which is based on EU Directives. There are some sector-specific regulations and exemptions applicable, for instance, to the rail sector, as well as with regard to the provision of services in water sector, energy or defense.

Under the key principles applying to the procurement process, contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

Investing in energy and infrastructure

Public procurement is relevant where public sector entities are seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium, to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset.

In most cases, the public sector entity will need to publish a contract notice in the Journal of Public Procurement (Vestník verejného obstarávania), as well as in the Official Journal of the European Union (OJEU) and run one of the following procedures:

- **Public tender** – This procedure is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the notice published in Journal of Public Procurement and in OJEU. Change and negotiations to the tender are not permitted.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following a stage in which the tenderers submit their requests for participation in the tender. Change and negotiations to the tender are not permitted.

- **Competitive dialogue** – This procedure suits the purposes of complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector entity.

- **Negotiation procedure with publication** – This procedure involves a shortlisting of at least three bidders who are invited to dialogue with the public sector. It is used when there is a need to develop a detailed innovative solution, whereas due to the nature or complexity of the subject matter of the order, the order cannot be awarded without the dialogue and in the previous public tender or restricted procedure all of the submitted offers were unacceptable.

- **Direct negotiation procedure** – Direct negotiation can be used for public procurement only under particular restrictive conditions stipulated by the Act on Public Procurement. Such conditions include, for instance, the fact that:
  - no entity submitted an offer in the previous public tender or restricted procedure, or no entity fulfilled the criteria of such previous procedure;
  - the requested services or goods may be provided only by a particular entity; or
Investors may, however, seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations.

**Financing energy and infrastructure**

On a publicly procured contract, the public sector entity may have prescribed requirements on the funding arrangements which have to be followed.

**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

The most common form of private sector funding in energy and infrastructure in Slovakia (including in relation to public-private partnerships) are loans made on a project-finance basis and provided by financial institutions on medium- to long-term bases, or provision of own resources by the private sector partner.

Funding/funding products can also be, sometimes, provided by the European Investment Bank or European Bank for Reconstruction and Development.

**Investing**

The most common form of investing in energy and infrastructure includes 'equity' investment in a special purpose project company (either a green field company or a functioning project) or in entities that may have a portfolio of interests.

**Restructuring**

**Enforcement and sanctions**

*When can there be regulatory investigations?*

When the National Bank of Slovakia considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

*What regulatory penalties may apply?*

When a rule breach has taken place, the National Bank of Slovakia may impose a financial penalty against the firm and/or regulated individuals, or withdraw regulated status.

*What criminal penalties may apply?*

Following formal investigation, the court may impose criminal penalties for any criminal offences, including:
• fraud, capital fraud;
• violation of obligations of trust;
• money laundering; and
• conducting business activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

ADVANCE OF LOAN

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN

There are no stamp, registration, transfer or other similar taxes payable on the transfer or assignment of a debt under a loan. Some administrative fees may, however, apply.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

No stamp, registration, transfer or other similar taxes are payable on the taking, transfer or assignment of a mortgage, debenture or other security. Some administrative fees may, however, apply.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of debt securities. Various fees, the rate of which depends on the relevant financial institutions, may apply to the issue of debt securities.

Last modified 6 Dec 2019 | Authored by independent tax advisor Radislav Bibel

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

No. Only the National Bank of Slovakia takes priority on the enforcement of security relating to secured lenders and secured debt security holders.

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Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?
Yes, withholding tax is imposed on interest payments under a loan.

**If so:**

**What is the rate of withholding?**

The rate of withholding tax in the case of interest payments by a taxpayer resident in the Slovak Republic to a taxpayer also resident in the Slovak Republic, is 19%.

In the case of interest payments paid to a taxpayer resident outside of the Slovak Republic but in a jurisdiction which has concluded a double tax treaty with the Slovak Republic, the withholding tax rate is 19% or such lower rate as may be stipulated in that double tax treaty, if applicable. In the case of interest payments paid to a taxpayer resident outside of the Slovak Republic in a non-contracting state (jurisdiction that has not concluded a double taxation treaty or an international treaty providing for the exchange of information for tax purposes with the Slovak Republic), the withholding tax rate is 35%.

**What are the key exemptions?**

Interest payments to banks or other lenders, in each case, resident in the Slovak Republic, are not subject to withholding tax.

An exemption may be applicable, in whole or in part, under a double tax treaty.

An exemption from withholding tax may also be applicable under the EU Interest and Royalties Directive, as implemented in the Slovak Republic, provided that certain conditions are met.

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

Yes.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

No.

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

Yes.

**Key contacts**

**Péter Györfi-Tóth**  
Partner  
Horváth & Partners Law Firm  
peter.gyorfi-toth@dlapiper.com  
T: +36 1 510 1120
South Africa

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

The South African debt capital market is regulated mainly by the Financial Markets Act (FMA), the Companies Act and the Banks Act. The Collective Investment Scheme Control Act and the Exchange Control Regulations may also be applicable to some debt instrument structures.

To offer and issue debt securities, an issuer must be registered as a bank, or authorized as a branch of a foreign bank under the Banks Act or must offer and issue debt securities in compliance with one of the available exemptions. The most prominent exemption for non-bank issuers is the exemption set out in the Commercial Paper Regulations which applies to prospective issuers that are listed companies or issuers that have a net asset value of at least ZAR100 million for at least 18 months prior to any issue of commercial paper.

The offer and sale of debt securities by a non-resident in South Africa is subject to the prior approval of the Financial Surveillance Department and SARB.

The Financial Advisory and Intermediaries Services Act (FAIS) prohibits any person other than a person licensed under the FAIS from marketing debt securities, acting as an intermediary in offers and sales of debt securities and recommending or providing guidance on the purchase of securities.

Last modified 5 Dec 2019

What are common issuing methods and types of debt securities?

A corporate special purpose vehicle (SPV) is commonly used for issues of asset-backed securities, high yield debt securities and other types of secured debt securities. This SPV structure is not generally used for issues of unsecured debt securities. The trust structure is not commonly used for issues of debt securities, as a trust is not the most tax-efficient way of structuring these types of transactions. However, there are circumstances where the trust structure has been used.

Types of debt instruments include:

- securities characterized by the type of interest or payment;
- debentures;
- bonds;
- notes;
- derivative instruments;
What are the differences between offering debt securities to institutional / professional or other investors?

The disclosure requirements

Section 96 of the Companies Act sets out types of offers that are not offers to the public.

They are:

- an offer to persons that deal with securities in the ordinary course of business, banks, mutual funds, financial institutions and financial services providers and wholly owned subsidiaries of banks, mutual funds, financial institutions and financial services providers; and
- an offer where the total acquisition cost of the securities for any single offeree is equal to or greater than a certain threshold, which is currently ZAR1 million.

Where the offer is not to the public, the offer does not require a prospectus.

When is it necessary to prepare a prospectus?

If the offer is an ‘offer to the public’ as defined in the Companies Act, the issuer must prepare and register a prospectus satisfying the requirements of the Companies Act. There are certain exemptions as to what constitutes an ‘offer to the public’ (see section 96 of the Companies Act as discussed above).

What are the main exchanges available?

JSE Limited (JSE)

Subject to compliance with both the Debt Listings Requirements and the listings requirements relating to the main market of the JSE, an issuer can list its debt securities on the main market of the JSE. An issuer may also list its debt securities on an alternative exchange of the JSE called the Interest Rate Market.

Is there a private placement market?

Yes.

Are there any other notable risks or issues around issuing or investing in debt securities?
Issuing debt securities and investing in debt securities

The JSE can suspend the listing of debt securities on failure by an issuer to comply with the Debt Listings Requirements of the JSE – which include ongoing disclosure obligations. The JSE can also censure the issuer (publicly or privately) or impose a fine or any other penalty that is appropriate in the circumstances.

Macro-economic risks

South Africa has recently received a credit-rating downgrade, which has prompted issuers to sidestep the bond market and opt for less public forms of fundraising. A number of South Africa’s state-owned entities are in precarious financial positions with their respective corporate governance structures coming under increasingly intense public scrutiny.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally, funds in South Africa are classified as collective investment schemes and are regulated by the Collective Investment Schemes Control Act (CISCA).

A Collective Investment Scheme is defined in CISCA as ‘a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which:

- two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and
- the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed’.

The primary forms of collective investment schemes are detailed in Establishing and investing in debt and hedge funds – common structures.

South Africa has recently received a credit-rating downgrade, which has prompted issuers to sidestep the bond market and opt for less public forms of fundraising. A number of South Africa’s state-owned entities are in precarious financial positions with their respective corporate governance structures coming under increasingly intense public scrutiny.

The definition of ‘Hedge Fund’ for the purpose of applying CISCA is ‘an arrangement in pursuance of which members of the public are invited or permitted to invest money or other assets and which uses any strategy or takes any position which could result in the arrangement incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include but are not limited to (a) leverage; or (b) net short positions.’

Although Collective Investment Schemes do not need to be registered, all companies which wish to manage collective investment schemes (Management Companies) must register with the Registrar of the Collective Investment Schemes in terms of section 42 of CISCA.

Also see Managing and marketing debt and hedge funds – investment management restrictions.

Provided that private equity funds are not made available to members of the public, the structures under which they operate are not directly regulated by the FSCA.

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What are common fund structures?

Asset managers and hedge funds

COLLECTIVE INVESTMENT SCHEMES (CIS) (BOTH HEDGE FUNDS AND UNIT TRUSTS ARE CLASSIFIED AS CISS)
CIS in securities
The portfolio consists mainly of securities and includes local funds registered with the FSCA (most collective investment schemes fall in this category).

CIS in properties
The portfolio consists mostly of shares in property investment companies or directly held property.

CIS in participatory bonds
The scheme consists mostly of participatory bonds.

Declared CIS
This is a scheme declared by the Minister of Finance as a CIS (e.g. hedge funds, as above).

Foreign CIS
These are foreign schemes which solicit investments from South Africans. In terms of Collective Investment Schemes Control Act (CISCA), a foreign CIS must apply to the Registrar of Collective Investment Schemes to be approved and registered.

En commandite partnerships
En commandite partnerships are regulated by the common law. The main advantage of this type of partnership is that a commanditant, or limited partner, is not liable for the debts of the partnership in an amount greater than its investment commitment to the partnership (provided applicable common law requirements are met). The managing partner (also known as the general partner) has unlimited liability for the debts of the partnership.

Also see Entity establishment.

Debenture funds
Investors in debenture structures subscribe for debentures issued by a company. The company lends or contributes the proceeds of such subscription to a trust. The trust appoints a hedge fund manager to manage its portfolio of assets, and vests income and gains resulting from the portfolio in the holders of the debentures (in their capacities as beneficiaries of the trust).

Private equity funds

EN COMMANDITE PARTNERSHIPS

See above and also see Entity establishment.

Bewind trusts
A bewind trust is a type of trust vehicle registered under the Trust Property Control Act, in terms which the applicable assets that are subject to the trust arrangements are owned by the beneficiaries of the trust, but the trustees of the trust hold and manage such assets. When a bewind trust is used for purposes of a private equity vehicle, the cash contributions of the investors to the trust form the initial assets of the trust. Each investor is a beneficiary of the trust, and the investors own the assets of the trust jointly in undivided shares in proportion to their respective contributions.

What are the differences between offering fund securities to professional/institutional or other investors?

In terms of board notice 52 of 2015 (Financial Sector Conduct Authority (previously known as the Financial Services Board): Determination on the Requirements for Hedge Funds) (Board Notice 52) there are two categories of hedge funds, namely Qualified Investor Hedge Funds (QIHFs) and Retail Investor Hedge Funds (RIHFs).
RIHFs are aimed at the general public whilst QIHFs are aimed at more advanced investors.

There are no requirements in order to invest in an RIHF and RIHFs are able to set their own minimum investment levels.

Only 'Qualified Investors' may invest in QIHFs. A Qualified Investor is an investor which invests a minimum investment of ZAR1 million per hedge fund and has:

- demonstrable knowledge and experience in financial and business matter which would enable the investor to assess the merits and risks of a hedge fund investment; or
- appointed a Financial Services Provider (authorized in terms of Financial Advisory and Intermediaries Services Act (FAIS)) who has demonstrable knowledge and experience to advise the investor regarding the merits of a hedge fund investment.

The regulations relating to QIHFs are not as stringent as those attached to RIHFs, with QIHFs having more autonomy over their risk profiles and not being subject to the same liquidity and exposure requirements as RIHFs. For more information, see Managing and marketing debt and hedge funds – investment management restrictions.

Are there any other notable risks or issues around establishing and investing in funds?

For more information, see Managing and marketing debt and hedge funds – investment management restrictions.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

In terms of the Collective Investment Schemes Control Act (CISCA), no Management Company (see Establishing and investing in debt and hedge funds – establishment) may publish any advertisement, brochure or pamphlet referred to in before the management company has been informed by the Registrar of Collective Investment Schemes that he has no objection to the terms thereof.

Qualified Investor Hedge Funds (QIHFs) may only be marketed to Qualified Investors (see Establishing and investing in debt and hedge funds – investor considerations), whilst any investor may invest in a Retail Investor Hedge Funds (RIHFs). As a result, RIHFs are more highly regulated than QIHFs in terms of the risk profile of the assets under investment.

For more information, see Managing and marketing debt and hedge funds – investment management restrictions.

Are there any restrictions on managing a fund?

No person may manage a fund which is open to the public for investment without being registered in terms of the Collective Investment Schemes Control Act (CISCA) or licensed in terms of the Financial Advisory and Intermediaries Services Act (FAIS).

For registration of Management Companies, see Establishing and investing in debt and hedge funds – establishment.

Under FAIS, four types of licenses are issued to asset managers:

- category I (issued to financial services providers providing non-discretionary intermediary services or advice);
- category II (issued to financial services providers who provide discretionary fund management);
- category IIA (issued to financial services providers who manage hedge funds on a discretionary basis); and
- category III (issued to administrative financial services providers who aggregate client funds or securities, often through providing one-stop investment platform services).
Such license holders (Authorized Financial Services Providers) are bound by principles and rules set out in the relevant codes of conduct created by the Financial Sector Conduct Authority (previously known as the Financial Services Board) (FSCA).

Individuals exercising oversight over the rendering of financial services by a license holder under the FAIS (Key Individuals) or who represent the license holder in rendering financial services to clients (Representatives) must successfully complete certain regulatory examinations prescribed by the FSB.

Hedge fund managers must comply with the Category IIA (Hedge Fund Financial Services Provider) license requirements under FAIS in order to manage investor funds. Hedge fund managers must also register as such with the Registrar of Collective Investment Schemes in terms of section 42 of Collective Investment Schemes Control Act (CISCA).

In addition to the above, hedge funds are regulated in terms of board notice 52 of 2015 (Financial Sector Conduct Authority (previously known as the Financial Services Board)): Determination on the Requirements for Hedge Funds) (Board Notice 52), in terms of which, inter alia:

- Both Qualified Investor Hedge Funds (QIHFs) and Retail Investor Hedge Funds (RIHFs) must appoint a separate depository for the safekeeping of assets.
- Managers of QIHFs and RIHFs must comply with leverage, liquidity and asset exposure restrictions imposed by the FSCA. Restrictions are also placed on a fund’s ability to invest in derivatives. RIHFs are placed under more stringent restrictions in terms of exposure limits and permitted securities for investment.
- All fund managers must report to the Registrar of Collective Investment Schemes on a quarterly basis, which report must contain information on, inter alia:
  - the value assets in long/short positions as a percentage of total assets invested;
  - the exposure permitted under the fund mandate and the actual exposure applied at quarter end;
  - the method used to calculate exposure; and
  - a list of all portfolios administered by that manager.
- Hedge fund managers must provide the Registrar of Collective Investment Schemes with their audited annual financial statement and annual report within 90 days of their year end.

**Entering into derivatives contracts**

*Are there any restrictions on entering into derivatives contracts?*

‘Derivative Instruments’ are included in the definition of ‘securities’ under the Financial Markets Act (FMA). Any person wishing to carry on the business of buying or selling listed securities must either be an authorized user or effect such transactions through an authorized user. As such anyone wishing to enter into listed derivatives contracts in South Africa must be authorized by a licensed exchange or enlist the services of such a person.

Unlisted derivatives (OTCs), have historically been largely unregulated. The large majority of OTCs in South Africa are traded and cleared bilaterally and there have been no central risk management regimes imposed outside of the limits which the counterparties impose upon themselves.

Following the 2007-2008 financial crisis, in line with its G20 obligations, South Africa begun the process regulating OTCs and is moving towards a system of central clearing by enacting the FMA, which requires (once fully implemented) that all future derivatives trading will need to be performed through central counterparties (CCPs). The counterparties will each contract with the CCP, which will result in the CCP taking settlement risk and thus being more circumspect in the types of transactions they allow.

No CCP's have, as yet, been licensed in South Africa and the regulation of the OTC market is currently managed through increased reporting requirements on entities which bilaterally clear derivative contracts. The latest draft amendments to the FMA include provisions to allow for the JSE Limited to act as clearing agent for OTCs until 2022, at which point all CCPs will need to be independently owned and managed.
What are common types of derivatives?

South Africa has a robust derivative market, which makes up approximately 7.5% of GDP, and as such uses all the main types of derivatives contracts, including:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

Banks are the primary traders of derivatives in South Africa and as a result the most commonly traded derivatives are:

- interest rate derivatives (swaps), which make up 85% of the derivative transactions traded in the South African domestic market; and
- foreign exchange derivatives (currency swaps), which make up approximately 12% of South Africa’s derivative trading.

Commodity and Agricultural derivative contracts (futures and options) are also traded extensively in the South Africa.

Are there any other notable risks or issues around entering into derivatives contracts?

As discussed above, South Africa has not been exempt from the regulatory attention afforded to OTC derivative trading, particularly in the last seven to ten years. As such the reporting requirements in respect of derivative transactions have become increasingly onerous and as South Africa begins licensing CCPs there will be additional compliance and regulatory costs imposed on people transacting in derivatives.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Unless exempted, lenders are required to be registered as credit providers and financial service providers with the applicable regulatory bodies.

Lending to individuals and/or juristic entities which fall within the scope of the National Credit Act (due to their lower level of annual turnover and asset value) is subject to greater regulatory scrutiny as the information that is required to be provided to those borrowers prior to entering into a credit is more extensive. The agreements also need to follow a prescribed format and must include certain prescribed information. There is a heavy onus on lenders in these circumstances to ensure that a borrower will not be over-indebted as a result of the credit made available by the lender to that borrower. A court may declare a contract which does not comply with the prescribed format unlawful and a lender will therefore not be able to enforce its rights thereunder.

All financial institutions are required to complete the necessary 'know-your-client' procedures in terms of the Financial Intelligence Centre Act before providing finance to a borrower. In relation to companies, these procedures involve the collection of information regarding the directors and shareholders of that company, ensuring that the company is duly registered in its jurisdiction of incorporation and that the company has filed the necessary tax returns for the preceding tax years.

Lending to state-owned enterprises and other government agencies is subject to a separate legislative regime. State-owned enterprises
are created by statute and the provision of finance to those state-owned entities will need to comply with the provisions of the legislation which governs that entity as read together with the Public Finance Management Act.

**Borrowing**

Borrowers are generally not restricted by legislation from borrowing. There may, however, be restrictions contained in the particular borrower’s constitutional documents with regards to the incurring of financial indebtedness. A detailed review of the borrower’s constitutional documents should always be a prerequisite to providing financing.

Also, in relation to the provision of financial assistance, see Giving and taking guarantees and security.

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**What are common lending structures?**

**Loans**

Other than pursuant to the provisions of the National Credit Act, as contemplated above, there is no prescribed structure for lending transactions and such transactions may be tailored to suit the commercial requirements of the parties.

A loan may be provided on a bilateral basis (a single lender providing the entire facility) or on a syndicated basis (multiple lenders providing portions of the overall facility) to one or multiple borrowers.

**Loan durations**

The duration of the loan is subject to negotiation between the parties. Generally, the duration of loans varies between:

- **bridging loans** – short-term loans, normally for up to three to six months (there are generally tighter operational restrictions placed on the borrower and the margin is higher than longer-term loans);
- **term loans** – provided for an agreed period of time and is made available for a specific purpose (the availability period of such loans ends once the borrower has utilized the loan for the applicable purpose);
- **revolving loans** – provided for an agreed period of time and may be redrawn if repaid; and
- **working capital facilities** – made available to the borrower for a period of 365 days and is repayable on demand (these types of loans are ordinarily utilized by the borrower to fund its general working capital requirements and may be redrawn if repaid).

**Loan security**

Loans may be secured or unsecured. For more information, see Giving and taking guarantees and security.

**Loan commitment**

Loans may be committed or uncommitted. It is common, in relation to committed facilities, for the lender to charge a commitment fee for the duration of the availability period of the particular commitment. In order for a loan to qualify as being uncommitted, the provision of that loan must be subject to conditions which are in the lender’s discretion (eg credit committee approval).

**Loan repayment**

Loan repayments vary according the commercial capabilities of the borrower and the purpose for which the transaction was implemented. Repayments vary between:

- **capital bullet** – the full amount of capital is repaid on the maturity date with interest being paid in arrears on each interest payment date (normally monthly or quarterly);
- **equal payments** – equal payments comprising capital and interest payable at set intervals during the term of the loan;
- **equal capital payments** – equal payments of capital plus accrued interest payable at set intervals during the term of the loan;
sculpted profile – instalments vary according to the borrower's projected income during the term of the loan; and

on demand – capital is repayable on demand with interest having been paid at set intervals during the term of the loan.

Preference shares

An alternative basis on which to provide financing is by way of subscribing for preference shares in the borrower. The advantage of using this type of funding is that the dividends that a preference shareholder receives (ie akin to the interest it would have received on a loan) is exempt from tax under South African tax legislation. In order to benefit from the exemption on dividends, the provision of finance by way of preference shares does, however, need to comply with the requirements set out in the Income Tax Act as to the purpose of such financing and the security provided for such financing. Failure to comply with the provisions of the Income Tax Act for preference share funding has the consequence that the dividends received on account of the preference shares are deemed to be interest (which is taxable) and, accordingly, the tax benefit of such preference share funding will be lost.

In the event of the insolvency of the borrower, a preference shareholder will rank behind secured creditors of the borrower and ahead of the ordinary shareholders of the borrower.

What are the differences between lending to institutional / professional or other borrowers?

Lending to large corporations/institutional investors is less burdensome, particularly on enforcement, than lending to individuals or small corporations. Enforcement of a lender's rights under a loan advanced by a lender to an individual or any other entity regulated by the National Credit Act requires the lender to first refer the applicable borrower to a debt counsellor in order to agree a payment plan before the lender is entitled to enforce its rights under the applicable credit agreement.

A lender is also obliged to ensure that, when lending to an individual or small corporation, that individual or small corporation will not become over-indebted as a result of loan advanced by the lender. The lender must take reasonable steps to ascertain a borrower's understanding of the credit agreement it is to enter into, its debt repayment history and its existing financial means, prospects and obligations.

Do the laws recognize the principles of agency and trusts?

Under South African law, an agent does not have locus standi (the right to bring an action) in litigious proceedings before South African courts. South African law therefore does not recognize the provision of security in favor of an agent (on behalf of other parties) or in favor of a trust (other than a trust which has been properly established in accordance with South African law). Further, the Deeds Registries Act does not permit registerable security (mortgage bonds, special notarial bonds and general notarial bonds) to be registered in favor of an agent. Security, under South African law, should be provided to the finance parties directly or to a special purpose vehicle (Security SPV) as described below.

For syndicated lending transactions, the most common security structure in the South African markets, involves the creation of a guarantee and indemnity structure and the interposition of a Security SPV (which is owned by an independent orphan trust). Pursuant to the structure, the special purpose vehicle issues an on demand guarantee in favor of the finance parties, in terms of which the Security SPV undertakes to guarantee the obligations of the borrower in favor of the finance parties. The security providers then enter into an indemnity agreement in terms of which the security providers indemnify the Security SPV against any claims made against it under the guarantee. All security provided by the security providers is provided in favor of the Security SPV as security for the security providers' obligations under the indemnity agreement.

Are there any other notable risks or issues around lending?

Generally
No contractual arrangement may breach a legal rule or public policy. Legal rules may be derived from statute or from the common law whereas public policy is a subjective determination made by a judge by taking into account various policy issues, including the spirit and purport of the Constitution of South Africa.

There are a number of rules regarding the charging of interest and penalties. For instance, the in duplum rule states that the amount of interest charged by a lender may not exceed the capital amount of the loan. Further, under and in terms of the Conventional Penalties Act, a creditor shall not be entitled to recover, in respect of an act or omission which is the subject of a penalty stipulation, both the penalty and damages or, except where the relevant contract explicitly provides, to recover damages in lieu of a penalty. A court may also reduce a penalty where it is of the opinion that the penalty is out of proportion to the prejudice suffered by the creditor.

The rights of a creditor may also be limited by application of insolvency, reorganization, business rescue or other similar laws and a creditor may therefore not be able to enforce its rights under a finance agreement to the full extent contemplated therein.

It is important that all financial assistance resolution have been passed as a failure to do so results in the provision of such financial assistance being void. For more information, see Giving and taking guarantees and security – restrictions.

Specific types of lending

Lending to individuals and small corporations which are subject to the National Credit Act requires the lender to take greater precautions in order to ensure that the borrower will not be over-indebted. For more information, see Lending and borrowing – borrower considerations.

Standard form documentation

Most syndicated and large bilateral financing transactions are governed by loan documentation based on the recommended forms published by the Loan Markets Association and which have been tailored to suit the South African market. Documentation developed in-house by the banks is more commonly used for smaller, bilateral finance arrangements.

Are there any other notable risks or issues around borrowing?

None.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are:

Financial assistance

When providing a guarantee or security for the obligations of a related or inter-related company the guarantor or security provider must be able to comply with the financial assistance provisions and solvency and liquidity requirements as contemplated in the Companies Act. The Companies Act considers the entry into of a guarantee and/or the provision of security for the obligations of a related or inter-related company as the provision of financial assistance. Financial assistance may only be provided if the shareholders of the company, as a first step, have passed a resolution authorizing the provision of that financial assistance, in particular, or financial assistance generally. In order for a company to provide financial assistance, the shareholders of that company must have passed such a shareholder resolution within the preceding two years.

As a further step, the directors of the company will need to pass a separate resolution authorizing the provision of the financial assistance and confirming that the company will comply with financial assistance provisions as contemplated in the Companies Act which require the directors to confirm that:

- the guarantor’s/security provider’s assets (fairly valued) exceed its liabilities (fairly valued);
• the guarantor/security provider will be able to pay its debts as they fall due for the 12 months; and
• the terms under which the financial assistance is proposed to be given are fair and reasonable to the company.

**Distributions**

The companies act includes, in its definition of a distribution, the incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares of that company or of another company within the same group of companies. The provision of a guarantee or security by a company in respect of the obligations of a company within the same group of companies would therefore be classified as a distribution. Accordingly, the company providing that guarantee and/or security will need to comply with the applicable provisions of the Companies Act and the directors of that company will need to pass a resolution confirming that, at the time the provision of such guarantee and/or security:

• the guarantor’s/security provider’s assets (fairly valued) exceed its liabilities (fairly valued); and
• the guarantor/security provider will be able to pay its debts as they fall due for the 12 months.

**Capacity**

The guarantor’s/security provider’s constitutional documents must make provision for that guarantor/security provider to enter into a guarantee and/or provide security for the obligations of a related party or a third party;

**Agency**

For information regarding the provision of security in favor of an agent, see Lending and borrowing – agency and trusts.

*Last modified 5 Dec 2019*

**What are common types of guarantees and security?**

**Common forms of guarantees**

The most common type of guarantee in financing transactions is a first demand payment guarantee where the guarantor undertakes to make payment in the event of a default by the borrower.

It is important to ensure that the guarantee creates a principal obligation to pay or perform regardless of the enforceability, validity or legality of the underlying obligation. For more information, see Giving and taking guarantees and security – other issues.

**Common forms of security**

The most common forms of security are as follows.

**PLEDGE OF SHARES**

Perfection requirements include the delivery of share certificates evidencing the shares together with signed, undated share transfer forms where the shares are in certificated form or the noting of the pledge on the account held by the security provider with a central securities depository where the shares are dematerialized.

**CESSION OF RIGHTS**

All incorporeal rights may be cede in security, provided that the subject of that cession does not expressly prevent the cession of such rights. The most common forms of rights ceded are rights in and to insurance policies and amounts payable thereunder; bank accounts and amounts standing to the credit thereof; key customer contracts; and debtors book.

**MORTGAGE BONDS**

These provide real security over immovable property and are required to be registered in the South African Deeds Office nearest to where the property is located. This form of security must be prepared and filed by a conveyancing lawyer.
SPECIAL NOTARIAL BOND

A special notarial bond is provided over specified movable assets and is required to be registered in the South African Deeds Office where the security provider’s principal place of business is located. This form of security must be prepared and filed by a conveyancing lawyer.

GENERAL NOTARIAL BOND

A general notarial bond is provided over the security provider’s movable assets in general and is required to be registered in the South African Deeds Office where the security provider’s principal place of business is located. This form of security must be prepared and filed by a conveyancing lawyer.

In relation to the Security SPV structure, also see Lending and borrowing – common structures.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

Guarantees must explicitly state that the guarantee creates a primary obligation and not a suretyship and that the guarantor’s obligations thereunder will not be affected by the enforceability, legality of validity of the underlying obligations. A suretyship under South African law creates an ancillary obligation and a defect in the underlying obligation will similarly impact the suretyship. By way of example, if a company is placed under business rescue, the business rescue practitioner is entitled to cancel certain contracts in order to improve the financial position of the company. If the main contract is cancelled, then the suretyship will too be cancelled as it is merely ancillary to the principal obligations.

If the financial assistance provisions of the Companies Act have not been complied with the provision by a company of that financial assistance will be void. Directors may, however, face personal liability, in certain instances, for failing to comply with the financial assistance provisions of the Companies Act.

Giving or taking security

Under, and in terms of, the Insolvency Act, a mortgage bond passed for the purposes of securing a debt that was not previously secured must be registered in the applicable South African Deeds Office within two months from the date on which the debt it is securing is incurred. If registration has not occurred within the aforementioned time period and the security provider is liquidated within six months from the date on which the mortgage bond was registered, the mortgage bond will not secure that debt.

It is also important for the board of directors to have confirmed that the security provider is able to comply with the provisions of the Companies Act relating to financial assistance and distributions (see above) as, upon the occurrence of the liquidation in insolvency of the security provider, a liquidator may consider the provision of the security to have been a voidable disposition and require the creditor to return the assets acquired pursuant to the enforcement of such security.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally
Banks Act No. 94 of 1990  
Co-Operative Banks Act No. 40 of 2007  
Financial Advisory and Intermediaries Services Act No. 37 of 2002  
Financial Intelligence Centre Act No. 38 of 2001  
Financial Markets Act No. 19 of 2012  
Income Tax Act No. 58 of 1962  
Mutual Banks Act No. 124 of 1993

**Consumer credit**

Consumer Protection Act No. 68 of 2008  
Insolvency Act No. 24 of 1936  
National Credit Act No. 34 of 2005

**Mortgages**

Home Loan and Mortgage Disclosure Act No. 63 of 2000

**Corporations**

Companies Act No. 71 of 2008  
Trust Property Control Act No. 57 of 1988

**Funds and platforms**

Collective Investment Schemes Control Act No. 45 of 2002

**Energy and infrastructure**

Civil Aviation Act No. 13 of 2009  
Electricity Regulation Act No. 4 of 2006  
Gas Act No. 48 of 2001  
Independent Communications Authority of South Africa Act No. 13 of 2000  
Petroleum Pipelines Act No. 60 of 2003  
Preferential Procurement Framework Act No. 5 of 2000

**Other key market legislation**

Broad-Based Black Economic Empowerment Act No. 53 of 2003  
Commercial Paper Regulations  
Competition Act No. 89 of 1998  
Conventional Penalties Act No. 15 of 1962  
Currency and Exchanges Act, No. 9 of 1933 (including the Exchange Control Regulations)  
Inspection of Financial Institutions Act No. 80 of 1998  
Securitization Regulations

Regulatory authorization

**Who are the regulators?**

The Bank Supervision Department of the South African Reserve Bank (the central bank of South Africa) (SARB), headed up by the Registrar of Banks, is responsible for regulating and supervising all banks and banking groups registered in South Africa.

The SARB and the Financial Surveillance Department of South Africa are responsible for implementing and administering South African
exchange control policy and as such oversee the inflow and outflow of local currency and other local assets.

The Financial Sector Conduct Authority (previously known as the Financial Services Board) oversees the non-banking financial services industry, which includes retirement funds, short-term and long-term insurance, companies, funeral insurance schemes, collective investment schemes (unit trusts, funds and listed derivatives) and financial advisors and brokers. The Financial Sector Conduct Authority (previously known as the Financial Services Board) also supervises JSE Limited (the Johannesburg Stock Exchange).

What are the authorization requirements and process?

Depending on the type of services a prospective applicant wishes to render in South Africa, an applicant must submit an application:

- to the Registrar of Banks, in accordance with the Banks Act in order to register as a bank in South Africa;
- in accordance with the Collective Investment Schemes Control Act (CISCA), to register as a manager of a collective investment scheme, (see Establishing and investing in debt and hedge funds); or
- to the Financial Sector Conduct Authority (previously known as the Financial Services Board) or a recognized representative body, in accordance with Financial Advisory and Intermediaries Services Act (FAIS) to become a financial services provider. FAIS regulates the activities of all non-banking financial services providers.

International banks can operate in South Africa as either a representative office or a branch with the approval of the Registrar of Banks. Each of these models is subject to the requirements of the Banks Act, and the overall regulatory oversight of the South African Reserve Bank. The authorization requirements and process (the process can take up to six months) in respect of branches are more onerous than those of representative offices, as representative offices are not authorized to accept deposits from the public.

Foreign investment funds may register as 'foreign collective investment schemes' under CISCA. In order to qualify for South African registration, a foreign fund must have an investment policy which is consistent with the requirements set out under CISCA.

What are the main ongoing compliance requirements?

The main ongoing compliance requirements include:

- the payment of annual fees, such as licensing fees;
- if required, maintaining required levels of capital; and
- adhering to any conditions of authorization imposed by regulators, such as continuous disclosure.

What are the penalties for failure to be authorized?

A person undertaking regulated activity without being duly authorized or exempt commits a criminal offence and is liable to imprisonment and, if applicable, fines.

Regulated activities

What finance and investment activities require authorization?

Generally

PROVISION OF CREDIT AND OTHER REGULATED ACTIVITIES
A person who is required to register as a credit provider but who has not done so must not offer, make available or extend credit, enter into a credit agreement or agree to do any of those things without first having registered as a credit provider with the National Credit Regulator. A credit provider includes:

- any person who extends credit under a credit facility;
- a mortgagee under a mortgage agreement; and
- a lender under a secured loan agreement.

A person must apply to be registered as a credit provider if the total principal debt owed to that credit provider under all credit agreements (as defined in the National Credit Act) exceeds the prescribed threshold. With effect from 1 November 2016, the current threshold has been set at ZAR nil. This has far-reaching consequences as companies providing employee loans will be required to register as credit providers in terms of the National Credit Act. A credit arrangement will only fall within the definition of 'credit agreement' in terms of the National Credit Act if the person providing the credit will earn some form of fee (such as interest).

Banks, pension funds and other collective investment schemes are also required to obtain licenses from the relevant regulators in order to carry on their businesses. In relation to legislation applicable to these entities, see Law and regulation.

PROVISION OF ADVICE

A person may not act or offer to act as a financial services provider, unless such person has been issued with a license by the registrar of financial services. A financial services provider is any person who as a regular feature of such person's business provides any recommendation, guidance or proposal of a financial nature in respect of the purchase of, or investment in, any financial product, the conclusion of any transaction aimed at the incurring of any liability or the variation of any term relating to a financial product.

Persons not domiciled in South Africa must also obtain a license in order to provide financial advice in South Africa.

Consumer credit

See above in relation to entities which are required to be registered as credit providers and financial services providers.

Are there any possible exemptions?

Certain persons may carry on business as a credit provider without having to register with the National Credit Regulator, for example, where that person carries on business in only one province in South Africa and it has complied with the provincial regulations applicable to it.

Financial services may also be provided without having to obtain a license if that person has been exempted from having to obtain a license under the Financial Advisory and Intermediaries Services Act.

Do any exchange controls or other restrictions on payments apply?

Payments out of South Africa are regulated by the Exchange Control Regulations published under and in terms of the Currency and Exchanges Act. Approval must be sought for the making of such payments from the Financial Surveillance Department of the South African Reserve Bank. Applications are required to be made through specified authorized dealers (including commercial banks).

There are also tax considerations which should be taken into account particularly when financing assets which are to be imported into South Africa.

What are the rules around financial promotions?
A credit provider must not harass a person in an attempt to persuade that person to apply for credit or to enter into a credit agreement or related transaction. Credit providers are restricted from entering into credit agreements at various times and at specific places unless they comply with a number of legislative requirements. Only persons that are registered as credit providers may advertise the availability of credit, or of goods or services to be purchased on credit.

Any advertisement concerning the granting of credit must clearly state the interest rate and other credit-related costs in the format prescribed by the applicable legislation.

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

**PRIVATE COMPANIES**

The choice for most setting up a business in South Africa. Private companies (denoted by the suffix Proprietary Limited (Pty Ltd)) are seen as separate legal, limited liability, entities and as such are taxed in their own right and offer the shareholders protection against liabilities (commonly known as the corporate veil). Private companies are not prohibited from having foreign shareholding and only require one shareholder and one director. The Companies Act, however, prohibits a private company from offering its equity to the public.

**PUBLIC COMPANIES**

A public company is a limited liability company incorporated to offer shares to the general public for purposes of capital raising. Public companies are identified by the suffix Limited/Ltd and have their own legal identity. Public companies must have at least three directors.

**PARTNERSHIPS**

A partnership is akin to a coming together of between two and 20 people who contractually agree to operate a profit-generating business together. They further agree to split any profits as per their agreement (usually in proportion to their interests). In establishing a partnership each partner needs to make a contribution, which contribution may be in cash, expertise or otherwise. A partnership is not a separate legal entity, leaving partners liable for the liabilities of the partnership and exposed to creditors of the partnership.

**FOREIGN COMPANIES**

Section 23(2) of the Companies Act requires a foreign company that has established a permanent 'place of business' in South Africa for more than 21 days to register as an 'external company', unless a separate legal entity (ie a private company) is established. The registered external company is colloquially referred to as a 'branch' in South Africa. The effect of registration is not to create a new legal entity, but merely results in the foreign company becoming subject to the Companies Act. Under the Companies Act, a branch does not enjoy an identity separate from that of the foreign company. Consequently, the foreign company will remain liable in respect of all acts carried on by the branch in South Africa through its employees/agents/directors. The foreign company must operate in South Africa in its own name and the foreign country in which the foreign company is incorporated must be disclosed. This therefore creates unlimited liability in South Africa for the foreign company.

**Funds**

**FOREIGN COLLECTIVE INVESTMENT SCHEMES**

Foreign investment funds may register as 'foreign collective investment schemes' under the Collective Investment Schemes Control Act (CISCA). In order to qualify for South African registration, a foreign fund must have an investment policy which is consistent with the requirements set out under CISCA.

**EN COMMANDE PARTNERSHIPS**
The principal vehicle housing South African private equity funds investing in South Africa is the limited liability partnership (called *en commandite* partnerships). A trust structure (called a *bewind* trust, and is governed by the Trust Property Control Act No. 57 of 1988) is also sometimes used. Unless the trust structure is used, there are no registration requirements for establishing, and no legislation regulating, *en commandite* partnerships.

An *en commandite* partnership is carried on by one or some of the partners, called the general or managing partner, to which every partner whose name is not disclosed (called a *commanditar* partner or partner *en commandite*) contributes a fixed sum of money on condition that he or she receives a certain share of the profit, if there is any, but that in the event of loss he or she is liable to his or her co-partners to the extent of the fixed amount of his or her agreed capital contribution only. Because *commanditar* partners are undisclosed, this means that they are not presented as partners, are not liable for partnership debts (enjoy limited liability), may not actively participate in the business of the partnership and cannot reclaim payment of their partnership contribution or payment of their share of the partnership profits in competition with the creditors of the partnership. The general partner of the *en commandite* partnership has unlimited liability toward creditors of the partnership in circumstances where the partnership's assets are insufficient to settle relevant debts.

*Is it possible to conduct lending or investment business through a branch or establishment?*

Yes. International banks can operate in South Africa as either a representative office or a branch with the approval of the Registrar of Banks. Non-banking foreign companies may also establish branches in South Africa in accordance with the Companies Act. As set out above, registration may be required as an 'external company' as contemplated in section 23(2) of the Companies Act.

**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

South Africa is recognized as one of the main FinTech hubs in Africa. South African FinTech companies are currently focusing on mobile banking, payment services and alternative financing. Major banks and FinTech companies are slowly starting to tap into the large unbanked population and are designing FinTech products aimed at this group.

**Mobile banking**

South Africa has experienced exponential growth in the uptake of mobile banking, mostly due to the fact that a large percentage of the South African population lives in rural locations with limited access to traditional banking infrastructure. Socially, there is a need for workers in urban areas to transfer money to dependents living in rural areas and with both parties having access to mobile phones, this creates a platform for the transfer of funds, thus providing banking services to the unbanked. The major South African banks have identified the need and there has been significant growth in the remittance space, through electronic wallet services.

**Peer-to-peer funding platforms and marketplace lending**

Lending platforms and crowdfunding arrangements are growing steadily in the South African market, in particular gaining popularity with small to medium-sized enterprises who are seeking funding. Retail and institution based interfaces have been developed by non-bank lending enterprises and the major banks and other financial institutions. In addition to corporate lending, these platforms are also being used for philanthropic purposes (an example being a major bank setting up a crowdfunding platform where individuals can contribute to assisting tertiary level students in paying their fees).

**Payment services**
In the mobile payment space, there are a number of startups which are receiving good traction from customers in South Africa. These startups offer a number of services, including mobile payment solutions for e-commerce and mobile businesses. There are some startups which are tackling the hugely successful funeral parlor industry, by introducing point of sale (PoS) devices which assist insurers and their clients in keeping track of payments using invoices, especially in rural areas where this type of insurance is prone to fraud.

Blockchain, smart contracts and cryptocurrencies

The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Cryptocurrency attracted a lot of attention in South Africa during 2017, with significant growth in trade volumes and token values. It has also been announced that the South African Reserve Bank is currently testing regulations with regard to bitcoin and other cryptocurrencies and will be introducing new rules regarding the use of cryptocurrencies in the coming months. The South African Reserve Bank also stated that it will be carrying out feasibility studies regarding the associated technology in South Africa and increasing numbers of South African FinTech startups are being established. According to bitcoinzar.co.za there are two fully licensed exchanges, ICE Cubed and Luno, and the first bitcoin ATM in South Africa has been installed in a Johannesburg suburb. There are more than five other unlicensed bitcoin exchanges which are currently operating in South Africa.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. AI and automated advice tools also impact the banking and private wealth advisor sectors; the implications include decreased human involvement although based on experiences elsewhere, it may be preferable to operate hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of information technology services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of FinTech business targeting this space in South Africa.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

Although banking and financial services are tightly regulated industries in South Africa, there is currently no FinTech specific regulatory regime. FinTech activity is therefore regulated by legislation which governs lending, deposit taking, investments and electronic communications and transactions. Broadly, these laws have onerous requirements and have a focus on protecting consumers.

Electronic payments platforms and regulation of peer-to-peer lenders

Electronic payment platforms

In South Africa, there is no specific legislation that regulates electronic payment platforms and peer-to-peer (P2P) lending. However, some of the provisions contained in the National Payment Systems Act 78 of 1998 relating to payment services can have application in the context of electronic payment platforms.

Peer-to-peer lenders
P2P or marketplace lenders are largely constrained by the National Credit Act, 34 of 2005 (NCA), which subject to certain exceptions, requires all lenders to register as credit providers. The NCA also regulates fees, interest and other charges that lenders may levy. P2P lending for project development purposes may also fall within financial intermediary services within the Financial Advisory and Intermediary Services Act, 37 of 2002 (FAIS), and as a result, lending through an online platform may trigger the requirement to obtain a license as a financial services provider under sections 7 and 8 of FAIS.

There are certain exemptions in sections 44(1) and (2) of FAIS, where the registrar of financial services providers may, based on a list of factors set out in section 44(1), exempt persons or categories of persons from the section 7 authorization requirements. It may be argued that a P2P platform could be exempted under one of these headings; however, there is no regulator approved route for these businesses and currently no specific regulations addressing the P2P space.

**Regulation of payment services**

The National Payment Systems Act 78 of 1998 (the NPS Act) identifies and regulates two kinds of persons in the market who are non-banks.

- A ‘systems operator’ is non-bank authorized to provide services in respect of payment instructions. In essence, a systems operator provides the electronic means to two or more persons to make payments and/or to receive the proceeds of payment instructions. A systems operator is required to be authorized by the Payments Association of South Africa, on behalf of the South African Reserve Bank. Any entity which effectively facilitates the transfer of information between a payment portal and a payment provider or acquiring bank will be authorized as a systems operator in terms of the NPS Act.
- A ‘third-party payment provider’ accepts money or payment instructions from other persons for the purpose of making payments on behalf of those other persons to third parties to whom those payments are due. A third-party payment provider may hold funds in its own bank account for a short period of time prior to paying those funds over to the third party concerned. This differs from systems operators, which provide the technology for the payments but typically do not receive money or the proceeds of payment instructions.

**Application of data protection and consumer laws**

In South Africa, the Protection Personal Information Act 4 of 2013 (POPI), is the proposed legislative framework for the protection of personal information. POPI will only come into effect in its entirety, by presidential proclamation, on a date which is still to be determined. In the interim, the laws relating to data protection and consumer protection can be found in several pieces of legislation, with the most pertinent being the Electronic Communications and Transactions Act 25 of 2002 (ECTA) and the Consumer Protections Act 68 of 2008 (CPA). Briefly, the CPA aims to create certain protections for consumers in the marketplace and to protect consumers’ rights to privacy, particularly in the context of direct marketing. ECTA also aims to provide consumer protection in the context of unsolicited goods, services and communications. In relation to the protection of personal information, ECTA merely sets out the principles to be used, when a data controller collects personal information electronically.

**Money laundering regulations**

In South Africa, the primary statute governing anti-money laundering is the Financial Intelligence Centre Act, 39 of 2001, as amended (FICA). FICA established a Financial Intelligence Centre and a Counter-Money Laundering Advisory Council in order to combat money laundering activities and the financing of terrorist and related activities; and it imposes certain duties on institutions and other persons who might be used for money laundering purposes and the financing of terrorist and related activities. FICA imposes obligations on accountable institutions to conduct customer due diligence and where the institution is unable to satisfactorily verify the identity of the customer, it is precluded from entering into a business relationship with the customer, may not conclude a transaction with the customer or must terminate the relationship in line with its risk and compliance procedures. However these provisions are only applicable to accountable institutions which include financial instrument traders, persons carrying on the "business of a bank", or persons carrying on the business of lending money against the security of securities. A number of FinTech companies may not fall within the definition of an accountable institution but may elect to comply with these provisions to manage their risk.

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What type of funding arrangements and incentives are available to FinTech businesses?

**Early stage**
With the current drive to grow the South African economy, attract foreign investment and ultimately increase employment in South Africa, small and medium-sized businesses in the FinTech sector are seeing an increase in funding and support opportunities from both the private and public sector.

**Private loans**

Given the inherent risk, unstructured loans from family or friends of founders are arguably the most viable funding option for startup and early stage FinTech businesses. FinTech businesses can also privately place shares in their enterprises in order to raise funds. In South Africa, because the angel investor community is still relatively small, the terms of this type of financing can range from relatively generous to extremely onerous. Angel investment sizes will typically range from as little as ZAR 100,000 to ZAR 4 million, with almost all such investments originating from personal relationships. Aspiring FinTech entrepreneurs with limited angel investor personal relationships can connect with the South African Business Angels Network in order to get in touch with parties interested in making angel investments.

**Venture capital and debt**

The South African Revenue Service and National Treasury, with effect from 1 July 2009, introduced section 12J to the Income Tax Act, 58 of 1962 (the Act) to cater for investments in venture capital (VC) companies. Section 12J of the Act allows a person who invests in VC shares through a VC company to claim an upfront tax deduction of a 100% of the amount invested. However, as an anti-avoidance measure, section 12J is subject to strict requirements that must be adhered to by both VC companies and investors. This is one of the ways in which South Africa has created an enabling environment for VC funding. VC companies in South Africa will only invest in a company that has a scalable business model and strong intellectual property with the ability to scale five to twenty times the value at which they buy in at within a limited time frame. A list of the main VC companies can be accessed through the Southern African Venture Capital and Private Equity Association [website](http://www.savcpea.org).

**Crowdfunding**

Given that the Financial Sector Conduct Authority (previously known as the Financial Services Board), which oversees the non-banking financial services industry in the public’s interest, has not crafted any regulations around crowdfunding there is a lack of certainty and as such no encouragement or protection for investors, making crowdfunding a less attractive investment option at present. As a result, both entrepreneurs and the economy miss out on the benefits that this funding model offers. There are however a number of platforms actively setting the South African crowdfunding space, namely, RainFin (which is an online lending marketplace that connects borrowers and lenders) and Uprise.Africa (which is looking to be South Africa’s first equity crowdfunding platform).

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

The amount of bank debt available to FinTech entrepreneurs is often limited by the security that can be offered against the loan. Senior debt requires security in the form of mortgage bonds, with security being registered over fixed assets, or in the case of term-financing of moveable assets. When making use of these forms of financing, financial institutions have no vested interest in the business’ ultimate success or failure and, as such, provide no on-going business support. The collateral requirements often make this an option that is out of reach of many aspiring FinTech entrepreneurs. However, this funding option is particularly attractive for FinTech enterprises with an existing track record and positive cash flows and those entrepreneurs wishing to retain control over the strategic direction of the enterprise.

**CAPITAL MARKETS FUNDING**

South Africa has both debt and equity capital markets which are accessible, subject to certain requirements, to enterprises.

**EQUITY CAPITAL MARKETS**

In South Africa, over the last couple of years, the sectors most actively raising finance by way of Initial Public Offering are healthcare, financial services and real estate, among others. Technology is a sector that is rapidly increasing its activity in the equity capital markets. Although, no FinTech focused business has listed on the Johannesburg Stock Exchange (JSE) to date, we have seen FinTech founders in South Africa raise funds by way of sale of business. For example, Tyme, a mobile money business, was acquired by the Commonwealth Bank of Australia, and Fundamo, a mobile based financial services enterprise, was acquired by Visa.
DEBT CAPITAL MARKETS

Subject to compliance with both the Debt Listings Requirements and the listings requirements specifically relating to the main board of the JSE, established FinTech enterprises, acting as issuers, can list debt securities on the JSE. To offer and issue debt on a public exchange securities, an issuer must be registered as a bank, or authorized as a branch of a foreign bank under the Banks Act or must offer and issue debt securities in compliance with one of the available exemptions. The most prominent exemption for non-bank issuers is the exemption set out in the Commercial Paper Regulations which applies to prospective issuers that are listed companies or issuers with a net asset value of at least ZAR 100 million for at least 18 months prior to any issue of debt securities. The offer and sale of debt securities by a non-resident in South Africa is also subject to the prior approval of the South African Reserve Bank.

PREFERENCE SHARES

Although typically reserved for larger businesses, an alternative basis on which to raise finance is by way of issuing preference shares. The advantage of using this type of funding is that the dividends that a preference shareholder receives are exempt from tax under South African tax legislation. In order to benefit from the exemption on dividends, the provision of finance by way of preference shares does, however, need to comply with the requirements set out in the Income Tax Act as to the purpose of such financing and the security provided for such financing. Failure to comply with the provisions of the Income Tax Act for preference share funding has the consequence that the dividends received on account of the preference shares are deemed to be interest (which is taxable) and, accordingly, the tax benefit of such preference share funding will be lost.

Incentives and reliefs

There are also some options for obtaining government grants which, unlike loans, are awards of money that do not need to be repaid. Grants from the South African government are typically tied in with key deliverables such as; black economic empowerment, job creation and developing the economy. The selection criteria is strict, the paperwork extensive and there are often on-going reporting obligations on the business receiving a grant. The government also offers low cost finance to entrepreneurs through state owned entities such as: the Industrial Development Corporation, the National Empowerment Fund, the Technology Innovation Agency and the Development Bank of Southern Africa. The application process for government grants and financing is highly competitive.

There are a range of FinTech accelerator programs in South Africa, which are looking to rapidly grow FinTech startups not just in South Africa but in emerging markets generally. In addition, the vast majority of large corporates in South Africa have government mandated enterprise development initiatives, which provide supplier opportunities, business support and in some instances, funding opportunities. Barclays Africa, for instance, has an established global innovation program called RISE which supports FinTech innovation, provides FinTech business development support and offers opportunities for global collaboration.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

There is no formal market for the buying and selling of loans. Rather, these transactions are negotiated between the lender looking to sell all or part of its participation in a loan and a financial institution interested in buying that particular interest. This process may need to be performed in consultation with the borrower, unless the facility agreement provides otherwise.

The most common ways of selling loans are:

- Assignment – Both the rights and obligations of a lender are transferred; assignment generally requires the consent of the borrower.
- Cession – All or a portion of the rights of the existing lender are transferred to the new lender; this may be done without the consent of the borrower, but notice should be provided.

Most finance documents cater for an ability of the finance parties to transfer with or without consent or to any persons listed on agreed list of transferees. The general market position is that no consent is required to transfer all or a portion of a loan following the occurrence
What are the main considerations when transferring a loan and related security?

The main considerations for transferring a loan and related security are whether:

- the underlying contract allows for such transfer;
- there are limitations on the financial institutions to whom the loan and related security may be transferred;
- the consent of the borrower or any other party is required for such transfer;
- there are any other formalities that need to be adhered to for the transfer of a loan and related security;
- the transfer will prejudice the borrower; and
- costs.

Using a Security SPV structure for syndicated transactions (see above) obviates the need for security to be re-registered in the event of a transfer of the loan. The timing and costs associated with transferring a loan are reduced considerably as a result of using this structure.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of infrastructure in South Africa is a combination of private, public (directly by government or through state-owned enterprises) and public-private partnerships. This applies to a large extent in respect of both economic infrastructure (energy, aviation, telecommunications and roads) and social infrastructure (education, health and housing).

The state has, however, maintained a near monopoly when it comes to rail infrastructure and to a large extent the corrections/prisons infrastructure (there are only two ‘privately owned’ prisons in South Africa and the South African government has stopped granting concessions to private corporations for the construction of private prisons).

Energy

Eskom Holdings SOC Limited, a state-owned enterprise (SOE) owns the bulk of the energy generation and transmission infrastructure in South Africa. The infrastructure ranges from a nuclear power plant (Koeberg Power Station in Cape Town), a hydro-electric power plant (Gariep Power Station), an open cycle gas turbine plant (Ankerlig Power Station), various coal fired power plants (such as Lethabo Power Station), a pumped storage scheme (Palmiet Power Plant) and various wind farm projects (such as Sere Power Station). Eskom is in the process of constructing a number of new coal fired power plants, the most prominent of which are Medupi Power Station and Kusile Power Station which are expected to be completed by 2021 and 2023 respectively.

In and around 2010 the government of South Africa launched a renewable energy program which saw a number of Independent Power Producers entering the energy sector and by the end of October 2016 Eskom had procured approximately 6400 MW from 102 Independent Power Producers. There have been five bid windows during which independent power producers bid for the right to set up renewable energy projects. The renewable energy projects are a mixture of wind, solar photovoltaic, biomass, biogas, and concentrated solar thermal plants.

The National Energy Regulator (NERSA) is the regulatory body tasked with the regulation of the electricity, piped-gas and petroleum pipelines industries in terms of the Electricity Regulation Act, the Gas Act and the Petroleum Pipelines Act.
The Independent Power Producer Procurement Programme is administered by the IPPPP Unit which was established by the Department of Energy (DoE), National Treasury and the Development Bank of Southern Africa (DBSA) for the purposes of delivering on the Independent Power Producer procurement objectives.

Telecoms infrastructure

Ownership of infrastructure in telecoms is also a combination of private and public (through an SOE) ownership. Telkom SA SOC Limited owns the bulk of the wireline telecommunications infrastructure and also owns a sizeable portion of the wireless telecommunications infrastructure. Wireless telecommunications infrastructure is mostly privately owned, with Vodacom and MTN being the largest players in this space.

The Independent Communications Authority of South Africa (ICASA) is the regulator for the South African communications, broadcasting and postal services sector. It was established in terms of the Independent Communications Authority of South Africa Act.

Transport infrastructure

RAIL INFRASTRUCTURE

Transnet SOC Limited, through its Transnet Freight Rail division (Transnet Freight Rail), controls the heavy rail infrastructure sector and owns the majority of South Africa’s extensive national rail network, representing approximately 80% of Africa’s total rail network as well as rolling stock.

The Passenger Rail Agency of South Africa SOC Limited (PRASA), an SOE, controls the passenger rail sector and owns a portion of South Africa’s national rail network through its Metrorail and Mainline Passenger Service divisions.

The Bombela Concession Company (RF) Proprietary Limited owns and operates the Gautrain rapid train service which services commuters from Sandton to O.R Tambo Airport and Pretoria to Park Station (Johannesburg CBD). The Bombela consortium is owned by private shareholders.

ROAD TRANSPORT INFRASTRUCTURE

Ownership of the road network is held by the state (through the South African National Roads Agency SOC Limited (SANRAL)), with concessionaires (the Bakwena Concession (Bakwena), the N3TC Concession (N3TC) and the TRAC Concession (TRAC)) performing infrastructural development and management on three major national routes.

AVIATION

Cargo and passenger aviation is a combination of state and private ownership. South African Airways SOC Limited and its divisions dominate the local passenger routes, however, there are a number of private passenger airlines which operate within South Africa. ComAir (through the British Airways franchise and Kulula) is the longest surviving private commercial passenger aviation company. A number of private airlines have taken to the skies since 1994, however, most of them have since been liquidated amid a harsh operating environment due to their failure to compete with the state-owned airlines and their access to public funds.

The major airports are owned and managed by the Airports Company South Africa (majority owned by the South African Government) most notably O.R Tambo International Airport and Cape Town International Airport. The only other international accredited airport in Johannesburg, Lanseria International Airport is privately owned and is host to a number of commercial and charter airlines.

The South African Civil Aviation Authority (established in terms of the Civil Aviation Act) is responsible for the regulation of the aviation industry in South Africa.

PORTS AND PORT TERMINALS

Transnet, through its various divisions dominates infrastructure ownership in this sector.

Transnet, through its National Ports Authority division (National Ports Authority) owns and provides port infrastructure at the eight commercial seaports in South Africa. The National Ports Authority owns 19 container berths, 36 dry-bulk berths, 29 break-bulk berths, 13 liquid-bulk berths and eight entrance channels with supporting breakwaters, turning basins, networks and utilities.

Transnet, through its Transnet Port Terminals division (Transnet Port Terminals) owns infrastructure or packing and unpacking of
containers, agricultural, breakbulk and mineral bulk.

Transnet, through its Transnet Pipelines division (Transnet Pipelines) transports 100% of South Africa's bulk petroleum products and owns a petroleum and gas transportation pipelines. It also owns a tank farm capable of carrying 30 million litres of petroleum products.

**Other infrastructure**

**DEFENSE INFRASTRUCTURE**

Defense infrastructure is owned by the state.

**EDUCATION INFRASTRUCTURE**

Ownership of education infrastructure is a combination of public and private ownership with public schools being in the majority. There are a number of prominent private schools which service the middle to high income market with two of the big private school players ie Curro and Advtech being listed on the JSE.

**HOSPITAL INFRASTRUCTURE**

Ownership of health facilities is a combination of public and private ownership. There are a number of private entities operating health centers most notably Netcare and Mediclinic hospitals.

*Last modified 5 Dec 2019*

**Are there special rules for investing in energy and infrastructure?**

**Generally**

The overarching consideration for any investment in infrastructure in South Africa, especially where government or regulatory consent is required, is the impact on the country's transformation agenda ie the impact of black economic empowerment (BEE). For example, in the renewable energy sector, each project has been required to have a certain level of black (as defined in the Broad-based Black Economic Empowerment Act) ownership. The Development Bank of Southern Africa provided the primary project finance funding for many of the BEE investors wishing to invest in these projects, allowing for greater participation by historically disadvantaged South Africans in the projects, as investors and developers.

**Energy**

This is a very regulated sector regardless of the type of energy infrastructure involved and there is a complex licensing regime which usually has the attainment of certain ownership thresholds for example, black ownership and procurement as prerequisites. Accordingly, potential investors must consider the impact of their investment on any licenses held by the investee entity as well as any potential local partners. Any investment that potentially dilutes black ownership in a project is unlikely to receive regulatory approval.

**Telecoms infrastructure**

South Africa's telecommunications sector is regulated by a number of statutes that enforce certain requirements for applications for different licenses and approvals to establish and operate telecommunications infrastructure.

The Independent Communications Authority of South Africa (ICASA) is the regulator for both the telecommunications and broadcasting sectors. A company wishing to deploy and operate a physical network will require an Electronic Communications Network Service license. An Electronic Communications Service license is required for a company to provide electronic communications services to customers on its own network or through another company's network. Some resources in the telecommunications sector are considered a scarce resource, and as a result there is certain criteria which applicants must meet to obtain the various licenses, with particular emphasis on meeting the South African black economic empowerment requirements and limiting the amount of foreign investment in telecommunications infrastructure to 30%.

**Transport infrastructure**

**RAIL, PORT AND PIPELINE INFRASTRUCTURE**
Any form of infrastructure development in relation to railways, ports and pipeline infrastructure will need to be done in conjunction with procurement processes run by Transnet Freight Rail, PRASA, National Ports Authority and Transnet Port Terminals and Transnet Pipelines respectively.

ROAD TRANSPORT INFRASTRUCTURE

As stated above, all national roads are controlled by SANRAL. These concessions granted to Bakwena, N3TC and TRAC are for 30 years and will expire around 2030. All road infrastructure development will need to be performed in conjunction with SANRAL and its procurement processes.

AIRPORTS

In order to service the international market an airport will need to be granted ‘international status’ from the Department of Home Affairs in order to have the ability to clear customs from the airport terminal.

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What is the applicable procurement process?

Investing in energy and infrastructure

The constitution of South Africa imposes certain obligations on government entities (including state-owned enterprises) to ensure proper and responsible expenditure of public funds and allows such government entities to give priority to the government's socio-economic goals particularly transformation. This is given effect to through the Preferential Procurement Framework Act which imposes certain thresholds to be met by an entity seeking to do business with an SOE for example with regard to the local goods and services to be procured as part of the contract or project. The Preferential Procurement Framework Act also requires bidders to submit a certificate issued under the Codes of Good Practice prescribed by the Broad-Based Black Economic Empowerment Act. This certificate indicates what level of black economic empowerment contributor the bidder is and depending on the level, a certain score is allocated to the bid and counts towards the overall evaluation of the bid.

Financing energy and infrastructure

There are no specific procurement processes which attach to the financing of energy and infrastructure but due to the fact that a funder may end up acquiring an interest in a project or investment pursuant to the occurrence of an event of default, funders may need to consider some of the aspects raised above which affect investors. Examples of such considerations may include the conditions under which certain licenses were awarded to certain project companies or restrictions on the transferability of shares in black-owned project companies, such that the project companies remain predominantly black-owned in terms of the black economic empowerment requirements of the tender prerequisites.

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What are the most common forms of funding / investing in energy and infrastructure?

Funding

Common forms of funding in energy and infrastructure are:

- **debt funding (senior, junior and mezzanine)** – both on a balance sheet basis and project finance basis; and

- **preference share funding** – this has been prominent in the renewable energy sector where the initial participants, particularly the black economic empowerment partners, were initially funded through development funding institutions (such as the Development Bank of Southern Africa and the Industrial Development Corporation) and, now that the projects are operational, are refinancing the development funding through the issue of preference shares (which entitle the holder to set dividends ahead of ordinary shareholders and to take over the issuer in the event of a default) to some of the investment banks, which results in a lower cost of funding for those investors.
Investing

The most common form of investing is through the acquisition of equity shares or concessions.

Restructuring

Enforcement and sanctions

*When can there be regulatory investigations?*

**Companies Act**

The Companies Act makes provision for any person to initiate a complaint in terms of which it is alleged that a person has acted in contravention of the provisions of the Companies Act. Upon receipt of a complaint the Companies and Intellectual Property Commission (CIPC) may elect:

- not to investigate the complaint if it appears vexatious or frivolous;
- refer the complaint to the Companies Tribunal for resolution; or
- appoint an investigator to investigate the complaint.

**Competition Act**

The Competition Commission is a statutory body constituted in terms of the Competition Act. The Competition Commission is empowered by the Competition Act to investigate, control and evaluate restrictive business practices, abuse of dominant positions and mergers in order to achieve equity and efficiency in the South African economy. One of the Competition Commission's stated objectives is to investigate and evaluate alleged anti-competitive conduct. As such the Competition Commission has wide-ranging powers to investigate any alleged or suspected anti-competitive conduct.

**FICA**

In terms of the Financial Intelligence Centre Act (FICA), an inspector may at any reasonable time and on reasonable notice enter and inspect any premises at which an 'accountable institution' (eg banks, lawyers, estate agents, insurers, casinos and forex traders) conducts its business, in order to investigate any possible non-compliance.

**Inspection of Financial Institutions Act**

Inspectors, appointed in terms of the Inspection of Financial Institutions Act (including the Registrar of Banks) have the power to investigate the affairs, or part of the affairs, of any financial institution (including registered medical schemes). Inspectors have the power to (i) summon any person and any document relating to the affairs of the financial institution and (ii) administer an oath or affirmation in order to examine any person referred to in (i). On the authority of a warrant issued by a judge or magistrate with jurisdiction, the inspector has wide ranging powers to search premises and seize documents and other evidence.

**What regulatory penalties may apply?**

**Companies Act**

In terms of the Companies Act, if the Companies and Intellectual Property Commission believes a person has contravened the Companies Act, it may issue a compliance notice to that person directing that any steps reasonably designed to rectify the contravention be taken. In the event that a company fails to comply with a compliance notice, CIPC may apply to a court for an administrative fine to be imposed.
Such administrative fine may not exceed the greater of:

- 10% of that company's turnover for the period during which the person failed to comply with the compliance notice; or
- ZAR1 million.

**Competition Act**

Section 59(2) of the Competition Act limits the maximum administrative penalty which may be imposed by the Competition Commission to 10% of that company's annual turnover (in South Africa and from its exports from South Africa) for the preceding financial year.

**Financial Intelligence Centre Act (FICA)**

The Financial Intelligence Centre has wide discretion when imposing 'administrative sanctions' within the following categories:

- a caution not to repeat the conduct which led to the non-compliance;
- a reprimand;
- a directive to take remedial action or make specific arrangements;
- the restriction or suspension of certain specified business activities; or
- a financial penalty not exceeding ZAR10 million in respect of natural persons and ZAR50 million in respect of any juristic person.

**Inspection of Financial Institutions Act**

Administrative penalties will be derived from the relevant legislation which the financial institution is found to have contravened.

*Last modified 5 Dec 2019*

**What criminal penalties may apply?**

**POCA**

The primary piece of legislation to combat organized crime, racketeering and money laundering is the Prevention of Organized Crime Act (POCA). In terms of POCA the courts may impose severe punishments in the form of fines or, in certain instances, imprisonment.

Convictions for racketeering activities can result in a fine of up to ZAR1 billion or life imprisonment being imposed.

Money laundering convictions may result in a fine of up to ZAR100 million being imposed or possible imprisonment for up to 30 years.

**Competition Act**

Any person convicted of an offence in terms of the Competition Act is liable to a fine not exceeding ZAR500,000 or to imprisonment for a period not exceeding 10 years, or to both a fine and such imprisonment.

**Companies Act**

Any person convicted of an offence in terms of the Companies Act, is liable:

- in the case of a contravention of section 213 (1) (disclosure of confidential information) or 214 (1) (false statement, reckless conduct and fraudulent conduct) to a fine or to imprisonment for a period not exceeding ten years, or to both a fine and imprisonment; or
- in any other case, to a fine or to imprisonment for a period not exceeding 12 months, or to both a fine and imprisonment.

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**Tax**

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Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

No stamp duty is imposed in South Africa.

Securities Transfer Tax is imposed on the transfer of securities, except as part of an intra-group asset-for-share transaction.

Intra-group transactions between related companies may result in tax roll-over provisions being applied, which allow for any tax consequences to be rolled over until the relevant assets are transferred outside of that particular group of companies.

Transfer Duty is imposed on the transfer of immoveable property, unless the transaction is subject to Value Added Tax (VAT). If the transfer of immoveable property is part of the sale of a business as a going concern between two VAT-registered persons, the transaction will be zero-rated and no VAT (or Transfer Duty) will be payable.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

The South African Revenue Service (SARS) is a preferred creditor under the Insolvency Act, 1936. However, SARS still ranks behind any secured creditors on the liquidation of a company, but ranks (with other preferred creditors) ahead of concurrent creditors.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

There is no withholding tax levied on interest payments made to South African residents.

Interest payments made to, or for the benefit of, persons not resident in South Africa (which includes individuals and natural persons) are subject to withholding tax.

If so:

What is the rate of withholding?

The withholding tax rate is 15%.

What are the key exemptions?

An exemption may be available (in whole or in part) under a double tax treaty where applicable.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not
otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

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Key contacts

Jackie Pennington  
Partner  
DLA Piper South Africa Services (Pty) Ltd  
jackie.pennington@dlapiper.com  
T: +27 (0)11 302 0824
Spain

Capital markets and structured investments

Issuing and investing in debt securities

*Are there any restrictions on issuing debt securities?*

There are restrictions on offering and selling debt securities under both Spanish and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Spain or to request that they are admitted to trading on a regulated market operating in Spain unless an approved prospectus has been made available to the public.

*What are common issuing methods and types of debt securities?*

The most common types of debt securities issued in Spain are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in Spain. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (i.e. debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

In Spain, the *Real Decreto Legislativo 4/2015, de 23 de octubre, por el que se aprueba el texto refundido de la Ley del Mercado de Valores* (Securities Market Law) considers as financial instruments all transferrable securities of public or private persons or entities and grouped in issues (an issuance of such securities is required). A transferable security is defined as any *in rem* right, regardless of its nature, which,
due to its legal configuration and rights of transfer, is capable of being traded on a financial market.

In general, debt securities which are also considered transferable securities include (but are not limited to):

- internationally issued bonds (bonos de internacionalización);
- bonds, debentures and similar securities representing part of a debt claim, including those which are convertible or exchangeable;
- mortgage covered bonds, mortgage bonds and mortgage participations;
- asset-backed securities;
- money market instruments (which means all categories of instruments which are normally traded on the money market, such as treasury bills, certificates of deposit and commercial paper, except those issued on a unique basis and excluding instruments of payment deriving from preceding commercial transactions that do not involve the capture of repayable funds);
- preference shares;
- territorial covered bonds; and
- warrants and any other derivative transferable security giving the right to acquire or sell any other transferable security or giving the right to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities, credit risk or other indices or measures.

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**What are the differences between offering debt securities to institutional/professional or other investors?**

The legal regime on public offerings of securities in Spain is governed by the Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public and admitted to trading on a regulated market (Prospectus Regulation), the Securities Market Law and Real Decreto 1310/2005, de 4 de noviembre, por el que se desarrolla parcialmente la Ley 24/1988, de 28 de julio, del Mercado de Valores, en materia de admisión a negociación de valores en mercados secundarios oficiales, de ofertas públicas de venta o suscripción y del folleto exigible a tales efectos (Royal Decree 1310/2005).

**Definition of public offering**

According to the provisions of Article 35 of the Securities Market Law and Article 38 of Royal Decree 1310/2005, an ‘offer of securities to the public’ or ‘public offering’ means a communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe for those securities.

Any offer of securities in Spain which is deemed to be considered as ‘public’ under the terms of the above referred definition, would entail the obligation for the issuer to have approved by and filed with the Comisión Nacional del Mercado de Valores (Spanish Securities and Exchange Commission, CNMV), an informative prospectus (folleto informativo), comprising:

- a registration document (documento de registro) disclosing information about the issuer;
- a securities note (nota de valores) describing the main terms and conditions of the offering; and
- a summary note (resumen) thereto (the Prospectus) (the Prospectus should be published through the CNMV's website).

**Exceptions to the definition of public offering**

Notwithstanding the above, according to the provisions of Article 35 of the Securities Market Law and Article 38 of Royal Decree 1310/2005, the obligation to publish a prospectus would not apply to the following types of offerings (which, therefore, will not be considered as public offerings):

- an offer of securities exclusively addressed to qualified investors (as defined below);
- an offer of securities addressed to less than 150 natural or legal persons per EU member state, without including the qualified
investors;

- an offer of securities addressed to investors who acquire securities for a minimum amount of €100,000 per investor, for each separate offer;

- an offer of securities the unit par value of which is not less than €100,000; and

- an offer of securities where the total consideration of the offer is less than €5 million within the EU, which limit shall be calculated over a period of 12 months.

**Private placement**

As opposed to a public offering, a private placement entails an offer to a relatively small number of selected investors as a way of raising capital. Every offer that does not qualify as a public offering will be considered a private placement. Thus, when any of the exceptions described above apply, the offer will not qualify as a public offering in Spain and, therefore, the issuer will not be required to complete any registration or filing or obtain any approval or consent from the CNMV, as Spanish competent authority, or from the relevant market, for making the offer available to investors in Spain.

**Qualified investors**

For the purposes of the exceptions referred to above, the principal categories of ‘qualified investors’ under Spanish law include:

- financial institutions and other entities which are required to be authorized or regulated to operate in the financial markets by a state, irrespective of whether it is a member state or a non-member state, including credit institutions, investment firms, insurance and reinsurance companies, collective investment schemes and their management companies, private equity funds, closed-ended investment schemes and their management companies, pension funds and their management companies, securitization funds and their management companies, commodity and commodity derivatives dealers and other institutional investors;

- national and regional governments, public bodies that manage public debt, central banks, international and supranational institutions such as the World Bank, the International Monetary Fund, the European Central Bank, the European Investment Bank and other institutions of a similar nature;

- companies meeting at least two of the following capacity requirements on an individual basis:
  - total balance sheet total equal to or above €20 million;
  - annual net turnover equal to or above €40 million; and
  - own funds equal to or above €2 million;

- institutional investors, beyond those specified in the bullet point above, whose main activity is to invest in securities and other financial instruments; and

- individuals and small- and medium-sized companies which request in advance to be treated as qualified investors and expressly waive their treatment as retail customers, and which are registered as such in the relevant client registries of the relevant entities providing investment services.

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**When is it necessary to prepare a prospectus?**

Under the Prospectus Regulation, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

For more information, see Issuing and investing in debt securities – investor considerations.

If the offer is deemed not to be made to the public, a Prospectus Regulation compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

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What are the main exchanges available?

The main exchanges on which debt securities are traded in Spain are:

- the AIAF Mercado de Renta Fija, S.A.U. (AIAF); and
- the Mercado Alternativo de Renta Fija (MARF).

AIAF

AIAF is the Spanish regulated market for corporate debt and private bonds integrated in Bolsas y Mercados Españoles (BME is the holding company of the Spanish regulated exchanges), the Spanish securities markets operator. AIAF is a regulated market and is under the control and supervision of the public authorities in respect of its operation, admission to trading and disclosure of information.

MARF

MARF is the Spanish alternative bond market and considered as an alternative funding resource where different solvent companies may raise funds through the issuance of bonds. MARF adopts the legal structure of a multilateral trading facility (MTF), hence, it is considered as non-official market, similar to those that may be found in other European countries. Thus, the access requirements of MARF are more flexible than the requirements for regulated markets and, as a consequence, MARF has a greater flexibility and lower costs throughout the issuance process.

Securities which may be admitted to trade in the MARF are those exclusively targeted to qualified investors and whose nominal value is of a minimum amount of €100,000 (i.e. they do not fall under the requirement to publish a prospectus).

Is there a private placement market?

There is no private placement market in Spain.

However, every offer that does not qualify as a public offering is considered a private placement (as stated in Issuing and investing in debt securities – investor considerations).

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are responsible for the information contained in the prospectus, and they may face both civil and criminal liability in respect of the inaccuracy of such information.

With respect to civil liability, the civil liability of the Issuer relates to the content of the prospectus and is contained in article 38 of the Securities Markets Law and articles 32 to 37 of the Royal Decree 1310/2005. However, this liability is only applicable when Spain is the home member state (i.e., when the Comisión Nacional del Mercado de Valores (Spanish Securities and Exchange Commission, CNMV) is the competent authority approving the prospectus).

In relation to criminal liability, the Spanish Organic Act 10/1995, dated 23 November, on the Criminal Code (the Criminal Code) includes a specific criminal offence which may affect issuers if the relevant securities are admitted to trading in a Spanish regulated market or multilateral trading facility. Article 282 bis of the Criminal Code provides that:

[T]hose who, as de facto or de jure managers of a company that issues securities admitted to trading on securities markets, falsify the economic-financial information contained in a prospectus used to issue any financial instruments or information that the company must publish and make known pursuant to securities market legislation, concerning its resources, activities and present
and future business, in order to attract investor or depositors to place any kind of financial asset, or to obtain financing by any means, shall be punished with a sentence of imprisonment of one to four years. Should the investment, deposit, placement of asset or financing be eventually obtained, causing damage to the investor, depositor, acquirer of the financial assets or creditor, the punishment shall be imposed in its upper half. Should the damage caused be sufficiently serious, the punishment to be imposed shall be one to six years imprisonment and a fine to be paid within six to twelve months.’

Investing in debt securities

Issuance of debt securities will qualify as a public offer, if:

- their terms and conditions are governed by Spanish law or by a non-EU or non-OECD country; and
- they are offered in Spain or admitted to trading in a Spanish regulated market or multilateral trading facility requiring a bondholder’s syndicate and the appointment of a commissioner, who will be the legal representative of the bondholders’ syndicate (there is also a requirement to convene investor meetings at the request of bondholders which represent, at least, 5% of bonds issued and not repaid).

The directors of the issuer and the commissioner may convene investors meetings. The investors meetings have to approve any modification to the terms and conditions of the bonds by majority. A reinforced majority is required to the amendment to the term redemption conditions of the bonds, and conversion or exchange of the bonds.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the Collective Investment Schemes Law (CIS) Law and the Close-ended Collective Investment Law and are therefore subject to regulation by the Comisión Nacional del Mercado de Valores (Spanish Securities and Exchange Commission, CNMV).

The CIS Law regulates open-ended collective investment schemes. The Close-ended Collective Investment Law regulates close-ended collective investment entities.

Open-ended collective investment schemes

The CIS Law defines CIS as entities whose corporate purpose is raising funds, assets or rights from the public in order to manage and invest in assets, rights, securities or other instruments, financial or otherwise, provided that the investor’s yield is established in accordance with the collective results.

Close-ended collective investment entities

The Close-ended Collective Investment Law defines close-ended collective investment as the investment carried out by venture capital entities and other collective investment entities whose divestment policy fulfils the following requirements:

- such divestments are made simultaneously for all investors; and
- the yield obtained by each investor is in accordance with the rights which correspond to each investor, according to the terms set forth in the by-laws or regulations of the entity for each class of shares or units.

What are common fund structures?
Open-ended collective investment schemes (open-ended CIS)

Open-ended CIS can have the form of investment company or investment fund (separated pool of assets with no legal personality, belonging to a number of investors, whose management and representation is carried out by a management company).

Open-ended CIS can also be of a financial nature or not, depending on the investments made. Open-ended CIS of a non-financial nature are those which invest in real estate assets.

Open-ended CIS may have restrictions in their investments. Therefore, open-ended CIS can qualify as UCITS or as non-UCITS, for the purposes of the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC). Non-UCITS open-ended CIS are also called hedge funds. Hedge funds can be pure hedge funds or funds of hedge funds.

Close-ended collective investment entities

Close-ended collective investment entities can also take the form of an investment company or an investment fund. Close-ended collective investment entities can take two forms, depending on the nature of their investments:

- **venture capital entities** – which have as their corporate purpose the investment in non-listed companies different from financial or real estate companies; and

- **other close-ended collective investment entities** – which can invest in all kind of assets, in accordance with a defined investment policy.

All close-ended collective investment entities qualify as alternative investment funds, as per the definition of the Alternative Investment Fund Managers Directive (2011/61/EU).

What are the differences between offering fund securities to professional / institutional or other investors?

Definition of marketing and reverse solicitation

Under the Collective Investment Schemes (CIS) Law and the Close-ended Collective Investment Law, offering/marketing of funds means attracting clients through an advertising campaign, by the CIS/close-ended collective investment entity or any other entity acting on its behalf or on the marketing entity's behalf, in order to raise funds, assets or rights to the CIS/close-ended collective investment entity.

For these purposes, marketing of funds shall be understood as any form of communication addressed to potential investors in order to promote, either directly or through third parties acting on behalf of the CIS/close-ended collective investment entity or on behalf of the management company of the CIS/close-ended collective investment entity, the subscription or acquisition of units or shares of the CIS/close-ended collective investment entities. In any case, there is marketing of funds when the CIS/close-ended collective investment entities or their management company approaches the investors through phone calls, home visits, personalised letters, emails or any other electronic means, which are part of a marketing and promotional campaign.

A marketing of promotional campaign in Spain means any campaign addressed to investors resident in Spain. In case of email or any other electronic means, the offer is deemed to be addressed to investors resident in Spain when the CIS/close-ended collective investment entity or their management company, or any person acting on their behalf through the electronic means:

- proposes the purchase or subscription of the shares or units; or

- furnishes to residents in Spain all the necessary information regarding the characteristics of the offer and how they can subscribe to the offer.

In light of the above, in the event that Spanish resident investors are contacted for the purposes of offering units or shares in a fund, this will be considered as marketing. If, on the contrary, a Spanish resident investor has requested the investment upon his/her own initiative, this would not be deemed as an offer (ie this would be a reverse solicitation).

Offering of funds to retail and professional investors
Open-ended CIS qualifying as UCITS can be offered/marketed to retail investors without limitation. However, non-UCITS open-ended CIS and close-ended collective investment entities can only be offered/marketed to professional investors with the following exceptions:

- funds of hedge funds can be offered to retail investors;
- hedge funds and close-ended collective investment entities can be offered/marketed to retail investors if:
  - such investors undertake to invest at least €100,000; and
  - such investors make an statement in writing declaring they are aware of the risks inherent with such investment (this exception is not applicable to hedge funds which invest in invoices, loans, or hedge funds which grant loans (these can only be offered/marketed to professional investors);
- venture capital entities can also be offered/marketed to retail investors if:
  - the investors are managers, directors or employees of the manager of the venture capital entity;
  - the investors ordinarily invest in listed venture capital entities; and
  - the investors have experience in these types of investments, i.e., management or advisory experience regarding a similar venture capital entity to that in which they want to invest.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Managing funds is a regulated activity under the Collective Investment Schemes (CIS) Law and Close-ended Collective Investment Law and therefore subject to authorization. For more information, see Managing and marketing debt and hedge funds – marketing restrictions.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

For more information, see Establishing and investing in debt and hedge funds – investor considerations.

Generally in Spain, the marketing of funds is regulated under the Undertakings for Collective Investment in Transferable Securities Directive regime or under the Alternative Investment Fund Managers Directive regime.

Undertakings for Collective Investments in Transferable Securities (UCITS)

UCITS, including those established in Spain, have an EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Managers Directive, marketing is defined as: a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the European Union.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens
access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).

**Are there any restrictions on managing a fund?**

Fund management in Spain is regulated under the **Collective Investment Scheme (CIS) Law** and **Close-ended Collective Investment Law**, their developing regulation and the **Comisión Nacional del Mercado de Valores** (Spanish Securities and Exchange Commission, CNMV) Rules. The CNMV is responsible for regulating funds, fund managers and those marketing funds and any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization.

Various restrictions arise on manager structuring/compensation and profit-sharing arrangements as a result of the regulations and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and scope and complexity of its activities. The rules impact on, among other things, reporting, equity remuneration, deferred compensation arrangements and clawback.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the **Alternative Investment Fund Managers Directive** (as implemented in Spain by the **Close-ended Collective Investment Law**) and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the **Undertakings for Collective Investment in Transferable Securities Directive** (as implemented in Spain by the CIS Law). Full CNMV registration involves a significant authorization process – three-to-six months from completion of the application which must include:

- for the manager, information on senior personnel (must be suitable persons etc), organizational structure, policies and procedures, remuneration practices; and
- for each fund, investment strategy, constitutional documents, depositary information and disclosure requirements.

However, AIFMs based in Spain may be exempted from full regulation on certain grounds, including managing assets under €500 million where assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers must still register with the regulator, are subject to limited reporting and it should be noted that they do not benefit from the general passporting for marketing purposes.

**Entering into derivatives contracts**

**Are there any restrictions on entering into derivatives contracts?**

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in Spain (such as a dealer) will ordinarily have to be authorized under the **Securities Market Law**, as such activity would be deemed as dealing on own account on financial instruments.

One of the key exclusions to the requirements above applies to persons who only deal in derivatives for risk management purposes. The **European Market Infrastructure Regulation** applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

**What are common types of derivatives?**

Derivative contracts are entered into in Spain for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.
All of the main types of derivative contract are widely used in Spain:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Spain are:

- interest rates;
- equity;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

There has been a number of national courts decisions (even from the Spanish Supreme Court confirming the jurisprudence) within the last years in relation to derivatives entered into with non-institutional/professional borrowers (mainly, consumers) in which the hedge provider has been sentenced to pay large sums given that, pursuant to the decisions, there was an error of understanding and a lack of information on the side of the borrower and, therefore, it executed the derivative not being duly aware of its possible consequences and costs (the courts understand that the providers, inter alia, breached any information requirements, ignored the financial knowledge of the customer and/or made available complex documentation and contracts without the due explanation of the underlying products). As a result, the institutions offering derivatives are nowadays really keen on their duties of information and clear documentation (including several pre-signing processes) and have ceased to offer certain kinds of products which were contentious.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending
Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, a lender that is not a credit institution or other entity registered with the Bank of Spain is required to register on a special administrative public registry before its commencing such lending activity (for foreign entities, the relevant registry is the State Registry created for this purposes within the Consumer General Directorate, or Dirección General de Consumo). There is no prior licensing requirement so this is a simple registration process.

Mortgage and consumer financing agreements are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis; and
- to deal with borrowers who fall behind with their payments.

Furthermore, regulated financing agreements have specific requirements around the information that shall be provided to the borrowers before the execution of the loan and during its life, how the agreement is drafted and formatted and what information must be included. In addition, borrowers under mortgage and consumer loans enjoy certain rights that they do not enjoy in case of non-regulated loans.

As far as exchange control regulations are concerned, there will be reporting requirements to the Bank of Spain on a Spanish resident who receives funds from a non-Spanish resident. The Spanish resident must comply with such reporting requirements (for statistical and information purposes only), if any, on a periodic basis. The timing of the reporting obligations depend on certain thresholds.

There are no additional restrictions that apply to foreign lenders making loans available to Spanish borrowers.

**Borrowing**

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

*Last modified 5 Dec 2019*

**What are common lending structures?**

Lending in Spain can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A financing can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Facilities will be structured to achieve specific objectives, e.g. term loans, revolving credit facilities, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

Within the last years, it has become increasingly popular to finance certain transactions (usually LBOs) through private placements issued by the borrower, which are subscribed by Alternative Capital Providers (instead of usual credit institutions). For more information, see Private placement.

**Facility durations**

The duration of a facility can also vary between:

- a term loan or credit facility, provided for an agreed period of time but with a short availability period;
- a revolving credit facility, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
• a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Facility security**

A facility can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

**Facility repayment**

A facility can also be repayable on demand, on an amortizing basis (in instalments over the life of the facility) or scheduled (usually meaning the facility is repayable in full at maturity).

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity and so additional protection will be afforded to borrowers. For more information, see Lending and borrowing – restrictions.

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**Do the laws recognize the principles of agency and trusts?**

No, the concept of a trust or a split between legal ownership and beneficial ownership is not generally recognized under Spanish law. Therefore, for instance, if security is granted in favor of a security agent or security trustee instead of each of the creditors, there is a risk that the Spanish courts may consider that the security agent or security trustee may only enforce the security in respect of the amounts owed individually to such security agent or security trustee under the secured obligations, but not in respect of the amounts owed to the other secured creditors. Therefore, it is highly advisable that, if possible, the security is granted in favor of all the relevant creditors.

Regarding the agency role, it is possible to appoint an agent to act on behalf of other lenders. This appointment will be principally for administrative purposes however, for example for the purposes of receipt of notices on behalf of each of the lenders.

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**Are there any other notable risks or issues around lending?**

**Generally**

Facility agreements and other finance documents are subject to general contractual principles and laws. For example, the Spanish courts have, in relation to payment obligations, the discretion to grant cure periods and to moderate the enforcement of any event of default having consideration to the debt and economic circumstances.

In relation to defaults, Spanish courts are reluctant to accept the early termination of a loan or the enforcement of security for reasons apart from non-payment of the financing or, in some cases, material defaults (e.g. financial covenants).

**Specific types of lending**

**MORTGAGE LOANS**

Specific to the area of mortgage lending is the issue of the Mortgage Credit Directive, which has been implemented in Spain through Law 5/2019, dated 15 March. This directive aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Law 5/2019 applies to mortgage loans granted for the purpose of acquiring or renovating a residential dwelling,
or acquiring property rights over land plots or buildings. It imposes a number of requirements on real estate lenders, including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

A lender is only entitled to declare the early termination of the loan on the grounds of non-payment of monies due in the event that this has been provided for in the loan agreement and duly recorded at the Land Registry. In the absence of an early termination clause duly recorded at the Land Registry, the lender is only entitled to claim the principal and interest overdue but not the whole amount of the loan. If the mortgaged property is transferred before the payment of any overdue instalment and there are other instalments not yet due, the property will be transferred subject to the mortgage corresponding to that part of the loan pending payment.

Early termination of the loan cannot be declared (and therefore security may not be enforced) unless the default in payment extends to (i) 3% of the total amount of the loan or 12 monthly instalments, if default occurs in the first half of the term of the loan; or (ii) 7% of the total amount of the loan or 15 monthly instalments, if default occurs in the second half of the term of the loan.

Law 5/2019 also applies to real estate credit intermediaries who are defined as any natural or legal persons that, not acting as a lender nor a notary public, engage in a commercial or professional activity, in return for remuneration, whether pecuniary or in any other form of agreed economic benefit, consisting in bringing a natural person into direct or indirect contact with a real estate lender. Real estate credit intermediaries are subject to registration and supervision requirements.

This law also regulates the advisory service provided by the real estate lender or credit intermediary. The advisory service in relation to the real estate loan is a separate activity from the granting and intermediation of real estate loans.

Consequently, real estate advice is configured as an ancillary activity to the real estate loan or intermediation, so that it can only be provided by those who are registered as lenders or intermediaries.

Regarding the registration regime, depending on the geographical scope of action of the real estate credit intermediary or lender, lenders and real estate credit intermediaries must be registered with the Bank of Spain or with the competent body of each Autonomous Community.

The Bank of Spain shall be responsible for the management of the registration of:

- real estate credit intermediaries and lenders that operate or are going to operate with borrowers with domiciles located throughout Spain or in the territorial area of more than one Autonomous Community, provided that they have their head office in Spain, regardless of whether they additionally operate or are going to operate through a branch or under the freedom to provide services in other EU States, and
- real estate credit intermediaries and lenders who are going to operate in Spain through a branch or under the freedom to provide services, whatever the geographical area in which they are going to carry out their activity.

The management of the registration of real estate credit intermediaries and lenders that operate or are going to operate exclusively with borrowers domiciled within the territorial scope of a single Autonomous Community shall correspond to the competent body of said Autonomous Community, provided that the headquarters of its central administration is located in the same.

Credit institutions and Spanish branches of foreign credit institutions providing services subject to Law 5/2019 are exempted from the obligation to register, as they are already authorized and registered in their condition of credit institutions.

**LEVERAGED LENDING**

In case of leverage lending, it is important to bear in mind the issue of any potential financial assistance. For more information, see Giving and taking guarantees and security.

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**Are there any other notable risks or issues around borrowing?**

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD) which outlines certain
measures for dealing with failing financial institutions, and which was implemented in Spain by Law 11/2015, of 18 June, on the Restructuring and Resolution of Credit Institutions and Investment Firms.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Spanish or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

There are some reporting requirements when a Spanish resident receives funds from a non-Spanish entity. All Spanish residents shall report to the Bank of Spain:

- own-account transactions with non-residents, however structured and/or settled (i.e. through accounts of residents in Spain or abroad, or through cash delivery); and
- the relevant balance of their total foreign assets and liabilities.

There is no requirement for Spanish residents to report to the Bank of Spain when the total aggregate amount of such transactions with foreign entities is less than €1,000,000 in any year, unless the Bank of Spain has specifically requested a report to be submitted.

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Giving and taking guarantees and security

**Are there any restrictions on giving and taking guarantees and security?**

Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors’ powers that would be preventative. The safe approach is often to have the directors of the company approve the giving of the guarantee or security by resolution. Likewise, if the guarantee or the security is going to encumber an asset which is considered as 'essential' for the relevant company (an asset shall be considered as essential if its value exceeds 25% of the total value of the assets of the company according to the latest approved balance sheet), the approval of the shareholders’ must be also obtained by resolution.

**Fiduciary duties**

Although Spanish law does not recognize a legal concept of 'corporate benefit', there might be a breach of fiduciary duties by the directors of a Spanish company giving a guarantee or security to the extent that the transaction pursuant to which the guarantee or security is given is not found to result in the ultimate corporate benefit of the company (the referenced directors must act diligently and loyally in the best interest of the company (i.e., judgement business rule and risk/benefit approach) and, in any case, in accordance with any applicable laws and the company's by-laws).

**Insolvency**

Pursuant to the Spanish Insolvency Law, any agreement entered into by a Spanish company within the two-year period preceding the adjudication of bankruptcy may be set aside by the relevant insolvency court if the insolvency officials can prove that it was detrimental to the insolvent estate

**Upstream restrictions**

Spanish private limited liability companies (sociedades de responsabilidad limitada) cannot grant loans, issue guarantees or provide
financial assistance in favor of shareholders or directors, unless such transactions have been authorized on a case-by-case basis at the shareholders’ meeting.

**Financial assistance**

Under Spanish law, the scope of the financial assistance prohibition varies depending on the corporate nature of the relevant company:

- a public limited liability company (*sociedad anónima*) may not advance funds, grant loans, grant guarantees/security or provide any kind of financial assistance whatsoever for the acquisition of its shares or of the shares of its parent companies (*sociedades dominantes*).
- a private limited liability company (*sociedades de responsabilidad limitado*) may not advance funds, grant loans, grant guarantees/security or provide any kind of financial assistance whatsoever for the acquisition of its shares or of the shares of any of its group companies.

Breach of financial assistance regulations may result in fines for the directors of the company granting the guarantee or security, and may also result in the guarantee or security or the relevant underlying transaction being deemed void. Any objection to the financial assistance must be invoked by the shareholders (usually minority shareholders) or the company's creditors.

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**What are common types of guarantees and security?**

**Common forms of guarantees**

There are two common forms of guarantees used in Spain.

**GUARANTEE (FIANZA)**

A guarantor undertakes to pay the guarantee obligation if the borrower fails to pay. The guarantor's liability with respect to the borrower can be either:

- **subsidiary (subsidiaria)** – the guarantor is only required to pay if the borrower fails to do so; or
- **joint and several (solidaria)** – the creditor may claim against the debtor or the guarantor at the same time.

As to each guarantor's liability with respect to other guarantors, it can be can be either:

- **several (mancomunada)** – each guarantor would only be required to pay up to the obligations expressly guaranteed by such guarantor; or
- **joint and several (solidaria)** – each guarantor would be liable for the total amount of the guaranteed obligations.

Usually, the guarantor's liability is joint and several (both with respect to the borrower and the remaining guarantors).

**FIRST DEMAND GUARANTEE (GARANTÍA A PRIMER REQUERIMIENTO)**

A guarantor undertakes to pay the guarantee obligation at any time, upon first demand from the relevant creditor, if the relevant conditions set out in the guarantee clause or agreement are met, without any further requirements or exceptions (other than willful misconduct of the creditor). The guarantee is autonomous and independent from the guaranteed obligation.

First demand guarantees are the most common form of guarantee used in Spanish wholesale financing transactions.

**Common forms of security**

There are two main types of security *in rem* available for creditors: mortgages (*hipotecas*) and pledges (*prendas*).

**MORTGAGE**

A mortgage may be sub-categorized as:
• a mortgage over real estate assets (*hipoteca inmobiliaria*); and
• a mortgage over movable assets (*hipoteca mobiliaria*).

PLEDGE

A pledge may be sub-categorized as:

• a pledge without delivery of possession (*prenda sin desplazamiento*); and
• a pledge with delivery of possession (*prenda con desplazamiento*).

The nature of the security taken will depend on the asset expressed to be subject to such security.

In this regard:

• Movable assets which may be subject to a mortgage include intellectual and industrial property rights, industrial machinery, commercial establishments, motor vehicles, tramways, train carriages and aircrafts.

• Movables assets which may be subject to a pledge without delivery of possession include machinery, stored merchandise, raw materials, agricultural machinery, works of art, credit rights arising from permits, licenses and authorizations, subsidies or from other agreements with governmental authorities, and other credit rights not represented by securities and not qualifying as financial instruments for the purposes of Royal Decree-Law 5/2005 of 11 March 2005, implementing Directive 2002/47/EC of the European Parliament and the Council of 6 June 2002 on financial collateral arrangements.

• Movable assets which may be subject to a pledge with delivery of possession include shares, quotas, credit rights, receivables and bank accounts.

When the creation of security triggers a significant amount of stamp duty tax and the relevant assets are not significant in the context of the transaction, it is standard market practice to grant a promissory security over the such relevant assets.

The promissory security does not grant to the beneficiary any *in rem* right over the asset expressed to be subject thereto, until:

• the relevant security is effectively granted; and
• each of the actions required for the perfection of the security is fully performed.

Finally, it is relevant to note that Spanish law permits the creation of guarantees and security interests in favor of future obligations (such as, those arising under the hedging agreements if not signed at closing of a transaction), provided that the main features defining the relevant future obligation are duly determined at the date of creation of the guarantee or security interest.

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**Are there any other notable risks or issues around giving and taking guarantees and security?**

**General considerations**

In general terms, under Spanish law, any guarantee, pledge or mortgage must guarantee or secure another obligation to which they are ancillary and which must be clearly identified in the relevant guarantee or security agreement. Therefore, the guarantee or security will follow the underlying obligation in such a way that the invalidity of the underlying obligation entails the invalidity of the guarantee or security, and termination of the underlying obligation will entail cancellation of the guarantee or security.

**Giving or taking security**

**FORMALITIES AND REQUIREMENTS**

As a general rule, pledges with delivery of possession (*prendas con desplazamiento*) over shares, quotas, credit rights, receivables and/or bank accounts must comply with the following requirements in order to be perfected:

• Notarization (by means of a deed (*póliza*) or a public deed (*escritura pública*)) is required.
In relation to share pledges, the pledgor should deliver the share certificates (títulos multiples) to the secured creditor or to a third party acting as custodian (usually, the agent or security agent) and it is particularly advisable to record the creation of the pledge on the share certificates. Those share certificates shall be kept by the secured creditor or the custodian until the cancellation of the pledge, when they shall be returned to the shareholder.

In relation to quotas’ pledges, quotas are not physically represented (there are not quotas certificates) so they cannot physically be delivered to the secured creditor or to a third party custodian so, in order to render the pledge effective, notice to the company shall be given and the pledge recorded in the (physical or electronic) book registry of quota holders (socios), kept by the company, and it is advisable to record the creation of the pledge on the public document evidencing the ownership of the quotas.

Notification to the relevant company, relevant counterpart and/or depository bank is not required for perfection purposes but advisable in order to ensure that, upon enforcement, payments are made to the account designated by the beneficiary).

In relation to bank accounts, although the pledgor may be allowed to deal with the account in the course of its business (unless otherwise agreed, usually until a default takes place), it is compulsory to keep a positive balance in the bank account during the life of the pledge and some sort of control over the account (it is usually opened with the secured creditor or such secured creditor is able to control certain actions of the depository bank) to justify the delivery of possession.

In relation to shares and/or quotas, the pledgor will retain voting rights and the rights to receive payment of dividends until enforcement, unless otherwise agreed in the pledge agreement.

Likewise, as a general rule, mortgages over real estate assets (hipotecas inmobiliaria), mortgages over movable assets (hipotecas mobiliaria) and pledges without delivery of possession (prendas sin desplazamiento) must comply with the following requirements in order to be perfected:

- The mortgages must be documented in a public deed (escritura pública) while the pledges may be documented in a deed (póliza) or a public deed (escritura pública), as the case may be.
- The assets must be adequately described and identified, as necessary, in the security documents.
- There must be due registration within the relevant Land and/or Moveable Assets Registry, as applicable (until the public document is duly registered, the relevant security will not be perfected).
- As regards floating mortgages (i.e., real estate mortgages securing multiple obligations), beneficiaries of such floating mortgages must always be ‘credit entities’ (i.e., those set out in article 2 of Law 2/1981 of 25 March, regulating the mortgage market), regardless of whether they are Spanish of foreign credit entities (such requirement would also apply to any assignee of a loan secured by a floating mortgage).

In relation to all the above, if the security is documented in a public deed (escritura pública), notarial and registration fees (as appropriate), along with stamp duty, shall apply. However, if the security is documented in a deed (póliza), no stamp duty will be levied.

With regard to registrar and notary fees, these are set by the government and are based on a sliding scale, although notary’s fees can be negotiated down if the value of the transaction exceeds €6 million.

With regard to stamp duty rates, this will depend on the region where the asset is located (rates vary from 0.5% to 1.5%). The stamp duty rate is calculated over the relevant secured amount.

ENFORCEMENT

Spanish law provides for specific enforcement proceedings in respect of each type of security referred to in sub-question above. However, as a general rule, enforcement proceedings will usually be based on a sale at public auction of the relevant asset, conducted either by a Court or by a Spanish Notary (or, in certain cases, a specialized entity), while the proceeds obtained out of the auction process shall be used to repay the secured liabilities.

In this regard, in order to be able to proceed to the enforcement of any security governed by Spanish law through summary enforcement proceedings, a so called ‘liquidity clause’, which complies with the formal requirements set out in Spanish Procedural Law, shall be included in the relevant secured financing agreement (whether it is governed by Spanish law or otherwise). Additionally, notarization of the underlying financing agreement (and sworn translation into Spanish if drafted in a different language) is also a pre-requisite in order to benefit from summary enforcement proceedings.

INSOLVENCY CONSIDERATIONS
Upon declaration of insolvency of a Spanish company, no security interests over assets of such insolvent company which are ‘necessary for the continuity of its business or professional activity’ can be enforced (this will also apply to enforcement proceedings commenced before the declaration of the bankruptcy will also be held up) until the earlier of:

- the date on which an agreement (convenio) which does not prevent the enforcement of the relevant security interest has been reached between the insolvent company and its creditors; and
- the date on which one year has elapsed after the declaration of insolvency.

Although the Spanish Insolvency Law does not include a definition of assets which are ‘necessary for the continuity of its business or professional activity’, shares or quotas of project finance SPVs will not fall into that category. There are no clear rules followed by the Spanish Courts in relation to the assessment of when an asset shall fall into such category, so an analysis on a case by case basis will be required.

Receivers of the insolvent company may prevent any security interest being enforced after the end of the above referred ‘stay period’ by immediately paying the relevant secured amounts, including an undertaking to pay amounts which become due in the future under the relevant agreement as ‘claims against the insolvency estate’ (créditos contra la masa) (provided that, should a receiver fail to pay future claims as they become due, the secured creditor will be entitled to enforce the relevant security interest).

Any claims owed by an insolvent company to a ‘related party’ will be regarded as subordinated claims. Moreover, any security interest granted by the insolvent in favor of the ‘related party’ will be set aside by the court.

Any transaction entered into by the insolvent company within the two years immediately preceding the declaration of insolvency which are deemed as ‘detrimental to the insolvency estate of the debtor’ may be set aside by a receiver.

The Spanish Insolvency Law does not provide for a definition of ‘detrimental to the insolvency estate of the debtor’, however, it presumes that the following transactions will be detrimental:

- transactions involving donations or prepayments in respect of obligations which otherwise would be due after the adjudication of bankruptcy (this presumption does not permit the submission of evidence to the contrary);
- transactions between the insolvent and related parties (this presumption allows for the submission of evidence to the contrary); and
- granting by the insolvent of in rem security in relation to pre-existing non-secured obligations (this presumption allows for the submission of evidence to the contrary).

In any other case, the burden of proof will be on the person or entity arguing that the transaction is detrimental to the insolvency estate of the debtor.

Notwithstanding the above, new security granted in the context of a refinancing process shall not be subject to rescission (save in the case of fraud), so long as the refinancing process/agreement complies with the following requirements:

- the refinancing agreement creates a ‘significant increase’ of the funds available to the borrower, or a modification of the terms by extending the maturity date or by entering into new obligations that replace existing obligations;
- the refinancing agreement must have been reached as a result of a viability plan ensuring the solvency of the debtor in the short and medium term;
- the refinancing agreement is approved by creditors representing at least the 60% of the total value of the liabilities (certified by the company’s auditor) at the time the refinancing agreement is executed; and
- the refinancing agreement and any other ancillary documents must be set out in a public document.

These rules apply to the validity of the refinancing agreement itself, as well as to any other obligation and/or payment deriving from or connected with such refinancing. It is also worth mentioning that the exception to the general rule of rescission shall also apply to other transactions where the above-mentioned requirements have been fulfilled prior to the application for insolvency proceedings.

Financial regulation

Last modified 5 Dec 2019
Law and regulation

**What are the main laws and regulations that apply to entities that are involved in finance and investments generally?**

**Generally**

- Law 10/2014, dated 26 June, on the management, supervision and solvency of credit entities (Ley 10/2014, de 26 de junio, de ordenación, supervisión y solvencia de entidades de crédito) (banking regulation)
- Royal Legislative Decree 4/2015, dated 23 October, which enacts the consolidated text of the Securities Market Law (Real Decreto Legislativo 4/2015, de 23 de octubre, por el que se aprueba el texto refundido de la Ley del Mercado de Valores) (securities markets)
- Royal Decree-Law 21/2017, dated 29 December, on urgent measures for the adaptation of the Spanish legislation to the EU legislation on securities market (Real Decreto-ley 21/2017, de 29 de diciembre, de medidas urgentes para la adaptación del derecho español a la normativa de la Unión Europea en materia del mercado de valores) (securities markets)
- Law 11/2015, dated 18 June, on the recovery and resolution of credit entities and investment services companies (Ley 11/2015, de 18 de junio, de recuperación y resolución de entidades de crédito y empresas de servicios de inversión) (recovery and resolution)
- Royal Decree-Law, dated 11 March, on the urgent measures to encourage productivity and improve public sector procurement (Real Decreto-ley 5/2005, de 11 de marzo, de reformas urgentes para el impulso a la productividad y para la mejora de la contratación pública) (collateral and close-out netting)

**Consumer credit**

- Law 16/2011, dated 24 June, on credit agreements for consumers (Ley 16/2011, de 24 de junio, de contratos de crédito al consumo) (credit agreements for consumers)

**Mortgages**

- Law 2/2009, dated 31 March, which regulates contracting with consumers of mortgage loans or mortgage-backed facilities and brokering services for loan or credit facility agreements (Ley 2/2009, de 31 de marzo, por la que se regula la contratación con los consumidores de préstamos o créditos hipotecarios y de servicios de intermediación para la celebración de contratos de préstamo o crédito) (mortgages with consumers)
- Law 5/2019, dated 15 March, on real estate credit agreements (Ley 5/2019, de 15 de marzo, reguladora de los contratos de crédito inmobiliario) (mortgages with consumers)

**Corporations**

- Royal Legislative Decree, dated 2 July, by virtue of which it is enacted the consolidated text of Companies Law (Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital) (companies law)

**Funds and platforms**


- Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) (Directiva 2009/65/ce del parlamento europeo y del consejo de 13 de julio de 2009 por la que se coordinan las disposiciones legales, reglamentarias y administrativas sobre determinados organismos de inversión colectiva en valores mobiliarios) (UCITS funds)

- Law 35/2003, dated 4 November, on the Collective Investment Schemes (Ley 35/2003, de 4 de noviembre, de Instituciones de Inversión)
Colectiva) (collective investment schemes)

Law 22/2014, dated 12 November, which regulates venture capital companies, close-ended collective investment entities and management companies of close-ended collective investment entities, and which amends Law 35/2003, dated 4 November, on Collective Investment Schemes (Ley 22/2014, de 12 de noviembre, por la que se regulan las entidades de capital-riesgo, otras entidades de inversión colectiva de tipo cerrado y las sociedades gestoras de entidades de inversión colectiva de tipo cerrado, y por la que se modifica la Ley 35/2003, de 4 de noviembre, de Instituciones de Inversión Colectiva) (closed-ended collective investment entities)

Other key market legislation

Bank Recovery and Resolution Directive (2014/59/EU) (Directiva de Reestructuración y Resolución) (recovery and resolution)

Capital Requirements Regulation (Regulation (EU) 575/2013) (Reglamento de Requisitos de Capital) (capital requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (Reglamento de Infraestructura Europea del Mercado) (derivatives)

Market Abuse Regulation (Regulation (EU) 596/2014) (Reglamento de Abuso de Mercado) (market abuse)

Markets in Financial Instruments Directive (2014/65/EU) (Directiva de Mercados de Instrumentos Financieros) (financial instruments)

Markets in Financial Instruments Regulation (Regulation (EU) 600/2014) (Reglamento de Mercados de Instrumentos Financieros) (financial instruments)

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Regulatory authorization

Who are the regulators?

The Comisión Nacional del Mercado de Valores (Spanish Securities and Exchange Commission, CNMV) is the conduct regulator for firms providing investment services and fund managers in both retail and wholesale markets, and also the prudential regulator for investment firms and fund managers. It is also responsible for enforcing the market abuse and listing regimes.

The Bank of Spain is responsible for the prudential regulation of credit institutions, payment and e-money service providers, financial credit establishments and real estate lenders and intermediaries. It is also the conduct regulator for firms providing banking, payment and e-money services, financial credit establishments and real estate lenders and intermediaries.

What are the authorization requirements and process?

Depending on the type of firm, a firm must apply to the Comisión Nacional del Mercado de Valores (CNMV) or Bank of Spain for authorization or registration, as the case may be.

The regulators must assess whether the application meets the required threshold conditions within six to twelve months (depending on the kind of entity) of the submission of the complete application.

The application fee depends on the type of the application ranging from €2,500 to €10,000.

The regulators will also approve key individuals (e.g. senior management) in their roles.

Authorized firms are listed on the Bank of Spain's register and CNMV's register.

What are the main ongoing compliance requirements?

Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance
requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and loss of regulated status.

Last modified 5 Dec 2019

**What are the penalties for failure to be authorized?**

A person undertaking a regulated activity without being authorized or exempt may be subject to a fine and other penalties (e.g. suspension of management position).

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**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

A person must not carry on a regulated activity in Spain unless authorized, registered or exempt.

A financial activity requires regulatory authorization and/or registration when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in Spain and it does not fall within any of the available exemptions.

- Specified activities include activities such as accepting deposits, mortgage lending, dealing in, managing, arranging and advising on investments, and establishing collective investment schemes.
- Specified investments include deposits, shares, debt instruments, options, futures, units in a collective investment scheme and government and public securities.

**Consumer credit**

Consumer credit activities are not regulated activities. However, the granting of mortgage loans to individuals or consumers requires prior registration of the mortgage provider in a designated register in the event that such mortgage provider is not a credit institution.

In any event, the granting of consumer credit in Spain is subject to complying with the requirements under Law 16/2011, dated 24 June, on the credit agreements for consumers.

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**Are there any possible exemptions?**

Depending on the nature of the regulated activity, and how this is performed with Spanish resident investors, such regulated activity can be undertaken without authorization.

For example, for banking services generally, the criteria used is the ‘characteristic performance test’, which focuses on whether the characteristic performance is fulfilled in Spain. For investment services, the criteria used is the ‘solicitation or initiative test’ which focuses on which party has taken the initiative to contact the other.

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**Do any exchange controls or other restrictions on payments apply?**

Spain does not operate any foreign currency controls.

For cases of cash being transferred to Spain or outside Spain, cash transfers equal or exceeding €10,000 have to be declared, but there is
no legal restriction on moving money in and out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

There are also anti-money laundering and tax considerations to take into account.

**What are the rules around financial promotions?**

The promotion of investment services is deemed also as a restricted activity which can only be undertaken by authorized entities.

**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

The most common types of legal entities are limited companies (*sociedad anónima*) and limited partnerships (*sociedad limitada*), both of which are body corporates with separate legal personality and limit the liability of their members.

Limited companies (*sociedades anónimas*) can either be private or public depending on whether their shares are offered to the public. Some activities require a particular type of entity to be used. For example, banks and investment firms need to be limited companies (*sociedades anónimas*).

Limited partnerships (*sociedades limitadas*) are similar to limited companies (*sociedades anónimas*) in many ways, the main difference being that the transferability of interests in limited partnerships has more restrictions than the transfer of shares in a limited company (which is generally unrestricted, unless otherwise stipulated in the articles of association of the limited company).

**Funds**

Investment funds can take the form of legal entities (*sociedades anónimas*) or separate pools of assets without legal personality (*fondos*).

Investment funds without legal personality shall always have a fund manager in charge of representing, administering and managing the fund.

Fund managers have to be set up as limited companies (*sociedades anónimas*)

**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes.

A company can conduct lending or investment business in Spain through an establishment (also known as a ‘branch’) but this does not create a separate legal entity.

Foreign companies having a Spanish branch need to be passported (if EU based) or authorized (if non-EU based) if they intend to conduct regulated activities. In addition, Spanish branches of foreign companies need to be registered with the Commercial Registry and with the Bank of Spain registry or the Comisión Nacional del Mercado de Valores (Spanish Securities and Exchange Commission, CNMV) registry. The Bank of Spain’s registry is in charge of registering Spanish branches of foreign credit institutions and payment services and e-money firms. The CNMV’s registry is in charge of registering Spanish branches of foreign investment firms and fund managers.
Foreign companies carrying on activities in Spain through a ‘permanent establishment’ will be subject to Spanish corporation tax.

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**FinTech**

**FinTech products and uses**

_What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?_

**Peer-to-peer funding platforms and marketplace lending**

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform, rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently, products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

**HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?**

Marketplace lending includes peer-to-peer (P2P)-type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to or rather than, individual investors on a traditional P2P basis.

**ISSUES FOR STARTUP MARKETPLACE LENDERS**

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt this will typically result in
the platform being treated as a securitization for the purposes of the European Union Capital Requirements Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

**Blockchain, smart contracts and cryptocurrencies**

**WHAT IS BLOCKCHAIN?**

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (e.g., in the case of cryptocurrencies such as bitcoin) or providing an indisputable record, for example, relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned'). Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?**

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

**WHAT IS A CRYPTOCURRENCY?**
The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether, based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by
way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Bank of Spain (Banco de España) and the Comisión Nacional del Mercado de Valores (CNMV) are the conduct regulators for firms providing financial products and services in both retail and wholesale markets.

The Bank of Spain is responsible for firms providing banking services, payment services and e-money services.

The CNMV is responsible for firms providing investment services and for regulated crowdfunding/crowdlending platforms.

GENERAL

A person must not carry on a regulated activity in Spain unless authorized or exempt. A financial activity requires regulatory authorization when: it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in Spain and it does not fall within any of the available exemptions. Where FinTech products and/or applications involve financial activity which require regulatory authorization, the firms providing such products and/or applications must be authorized by the Bank of Spain or the CNMV, as applicable.

FINTECH/INNOVATION PORTAL AND REGULATORY SANDBOX

In December 2016, the CNMV launched the Fintech/Innovation Portal.

The CNMV has made available a space on its website (called the FinTech Portal) in order to receive information and requests of any kind related to the FinTech phenomenon. It provides an informal channel of communication for the CNMV to exchange information with promoters and financial institutions on their initiatives in this area.

The philosophy of this portal or FinTech space is to provide quality customer service and supervision, as the CNMV's aims with respect to Fintech are to be receptive, respond to queries and help where possible so that projects can be authorized.

In short, the aim is to enable the FinTech aspect of any project, to the extent that it conforms to the legal requirements, so that it does not hinder its success.

The CNMV has created a multidisciplinary internal group, made up of technicians from all of the CNMV departments that relate to Fintech, in order to assist the Portal, improve internal coordination and thus provide an agile response to the requests that are sent to the CNMV.

Of the enquiries received to date by the CNMV, most relate to crowdfunding and the digitization of financial services. There have also been a significant number of queries relating to automated advice or robo advisors and various enquiries about social trading, big data and Distributed Ledger Technology or blockchain.

The CNMV has issued Q&A documents on these FinTech topics.

The Ministry of Economy is currently working on the launch of a regulatory sandbox. This would be a 'testing space', governed by a set of rules previously determined by the regulator, which would allow companies to test new technology or innovative products and services in a secure environment.

A fundamental requirement of the sandbox is that tests would only be performed on a certain number of people, previously defined and agreed with a supervisor.

In addition, companies that participate in the sandbox will have the certainty that if they work during the tests as agreed with the regulator, they will not be sanctioned for carrying out a regulated activity without a license.

The role of the supervisor in a sandbox is to evaluate the legal framework of the products, services or innovative business models being tested.
REGULATORY DEVELOPMENTS ON CROWDFUNDING/CROWDLENDING PLATFORMS

Crowdfunding/crowdlending is regulated in Spain in Law 5/2015 on the Promotion of Business Financing. Crowdfunding/crowdlending in Law 5/2015 is known as Participative Financing Platforms (PFP) and these are based on the principle of neutrality in the coming together of investors and promoters.

PFPs are companies authorized by CNMV, whose activity consists of contacting, through websites or other electronic means, natural or legal persons offering financing, with natural or legal persons who request funding in their own name, to use it for a project. The projects financed are related to business, training or consumer affairs.

Up to November 2019, 29 PFPs have been authorized; many of them are generic (that is, they are set up for any type of project), other projects are focused on real estate, corporate social responsibility, technological sectors and training courses. The Ministry of Economy and CNMV are currently carrying out a review of Law 5/2015 to strengthen this industry and investor protection.

PFPs are intended to be an alternative channel to bank financing. It is also reasonable to expect that many of the companies financed through them will be able to move to the stock markets more easily, either directly or through venture capital, generating a larger capital market in Spain.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

A number of FinTech businesses are offering electronic payment platforms to rival traditional payment systems and the future implementation of the European Union Payment Services Directive II in Spain will recognize the rise in such business, with the aim of creating a more level playing field for payment services providers, while addressing the need for enhanced security and customer protection.

Spanish law also regulates the issuance of electronic money (e-money). E-money is defined as electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person other than the electronic money issuer and includes pre-paid cards and electronic pre-paid accounts for use online. Generally, firms issuing e-money must be authorized and registered with the Bank of Spain.

PEER-TO-PEER LENDERS

Generally, lending in Spain is not a regulated activity which requires the authorization of the Bank of Spain. However, the granting of mortgage loans to consumers and individuals requires the prior registration of the mortgage loan provider in a designated register in the event that such mortgage provider is not a credit institution.

In addition, the granting of consumer credit in Spain is subject to complying with the requirements under Law 16/2011, dated 24 June, on credit agreements for consumers.

Therefore, unless caught by the above mentioned requirements or by the fact that the peer-to-peer (P2P) lender meets the requirements of PFPs (crowdlending platforms), there are no specific regulations for P2P lenders.

Regulation of payment services

Where a Spanish business provides payment services as a regular occupation or business activity in Spain, it will require authorization by the Bank of Spain to become an authorized payment institution under the Spanish Payment Services Royal Decree-Law 19/2018. Failure to obtain the required authorization is a very serious administrative breach. Please note that Spain has not yet implemented partially the European Union Payment Services Directive II.

In order to become authorized by the Bank of Spain, a payment services business will need to meet certain criteria, including, in relation to its business plan: initial capital, processes and procedures for safeguarding relevant funds, sensitive payment data and money laundering, along with other controls.

Application of data protection and consumer laws
EU General Data Protection Regulation 2016/679 ("GDPR") and Spain’s Data Protection and Digital Rights Guarantee Fundamental Act 3/2018/1999 ("NLOPD") regulate the processing of personal data within Spain. The NLOPD develops and completes the GDPR, which is directly applicable all across the European Union. The new regulatory framework for privacy reinforces the information duties of data controllers (the entities or individuals deciding on how the personal data shall be processed). It also replaces the prior pre-eminence of consent by a more diverse scenario, in which compliance with contractual and legal obligations and even the legitimate interest of controllers may be preferable as legal basis for processing. Fines are much higher than before, reaching 20 million euros or the 4% of the global turnover of the controller in most serious cases.


Money laundering regulations

The Anti-Money Laundering and Terrorist Financing Law 10/2010 gives the Executive Service for Anti-Money Laundering (SEPBLAC) responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment. This law and its implementing regulations have partially implemented the European Union’s Fourth Money Laundering Directive.

Generally, where a firm is authorized and supervised by the Bank of Spain or CNMV, it will also be authorized and supervised by the SEPBLAC for compliance with anti-money laundering requirements. Electronic currencies such as bitcoin and cryptocurrencies tend to represent a high money-laundering risk.

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector is being establishing progressively in Spain, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdcube, which is one of the 29 regulated crowdfunding/crowdlending platforms in Spain as of November 2019.

There are two main types of crowdfunding: equity and reward-based.

• Equity crowdfunding involves company shares being given in exchange for investment in the business.

• Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or an application that the business is developing. This type of crowdfunding is not regulated under Law 5/2015.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses, to which they may otherwise not have had access.

ACCELERATORS

There are various incubators or accelerators in the Spanish market which offer support, facilities and funding for startups, often in return for an equity stake.
Venture capital and debt

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

Warehouse and platform funding

Warehousing financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date.

Another alternative form of funding is by way of crowdlending platforms (Participative Financing Platforms regulated under Law 5/2015), which bring individual borrowers and lenders together without the involvement of traditional banks. Crowdlending does not involve equity investments, and instead interest is paid on the money borrowed.

Senior bank debt and capital markets funding

**Senior Bank Debt**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**Capital Markets Funding**

Spain has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) could be a funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as any of the four Spanish Stock Exchanges (Bolsas de Valores). The Alternative Stock Market (Mercado Alternativo Bursátil or MAB) in particular caters for small, growth-orientated companies.

FinTech companies may also start to access funding by issuing bonds as a way of raising more competitive funding.

**Convertible Bonds/Loan Notes**

Another funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes, which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

Incentives and reliefs

The ‘business angel’ regime is designed to encourage investment in small, early-stage companies by offering a 30% income tax deduction for individuals who acquire shares of qualifying startups. The deduction base is limited to €60,000 per year. In addition, capital gains derived from the sale of these shares are exempt from Personal Income Tax, provided the investor reinvests the amounts resulting from
the sale in the acquisition of shares of another company of new or recent creation.

Research and development (R&D) deductions from CIT (Corporate Income Tax) are an incentive to increase investment in R&D. The deduction rates are 25% to 42% (R&D expenses) and 8% (acquisition of certain fixed assets used for R&D activities).

The Patent Box regime provides for a reduction on net income derived from the licensing of qualifying intellectual property, (patented inventions etc.) subject to compliance with certain requirements.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party’s rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

- **Assignment** – An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. An assignment can be effected as either an equitable assignment or legal assignment depending on whether certain statutory requirements have been satisfied.

- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

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What are the main considerations when transferring a loan and related security?

There are a number of issues to consider when transferring a loan or portfolio of loans. Some of the key considerations include:

- **nature of assignment** – whether if the assignment is for the contractual position or just the economic rights;

- **effective date** – determination of the moment when the economic rights are effectively assigned by the assignor;

- **security** – determination of the security under the relevant loan, in particular the ranking and registration of the security (a transferee creditor cannot enforce any registered security if the transfer is not registered too – however, the registration of any transfer triggers stamp duty);

- **court information** – if the loan has been challenged before the courts before its assignment, it will be important to obtain all the information regarding the judicial proceeding and the legal advisors involved in the ongoing claims;

- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed without the prior consent of the borrower;

- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
• **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

• **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms;

• **consent** – whether a transfer requires the consent or notification of any other parties;

• **notification** – notification to the borrower is not mandatory (unless otherwise agreed under the loan), however, is essential in order for existing borrowers to effect payment to the assignee to know who should repay the credit to and to avoid potential set offs between assignor and assignee; and

• **registration** - even if it is not a requirement under the loan, the transfer agreement should be granted by means of a Spanish public document if the underlying agreement was also notarised before a Spanish public notary.

_Last modified 5 Dec 2019_

**Projects**

**Financing / investing in energy / infrastructure**

_To what extent are energy and infrastructure assets publicly or privately owned?_

**Generally**

The ownership of energy and infrastructure assets in Spain varies according to the asset class. The main asset classes are usually considered to be:

• economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and

• social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

**Energy**

The gas and electricity industries in Spain are privatized, with the generation, transmission, distribution and supply services provided by a number of private sector companies. The relevant private sector companies own the generation, transmission and distribution assets. Notably, the private company _Red Eléctrica de España_, S.A. (REE) owns all the high voltage electricity grid. The private company _ENAGÁS_, S.A. is the main gas natural transport operator in Spain and it is certificated as a Transmission System Operator (TSO) by the Spanish public authorities and the European Commission.

The private sector finances and delivers most of the required infrastructure but there are a number of government policy mechanisms (adopted through legislation) which are used to incentivize investment in eligible energy generation technologies.

The principal body of the energy sector in Spain is the National Authority for Markets and Competition (CNMC), as the new independent authority in charge of both competition and regulatory matters in Spain in the fields of energy, electronic communications, audiovisual, postal and transport (railway and airport).

CNMC is fully independent from the Government, Public Administration and market players, has organizational and functional autonomy and is subject to judicial and parliamentary control.

**Telecoms infrastructure**

The telecommunications networks (fixed and mobile) in Spain are privately owned by a number of service providers. A good example is Telefonica which is responsible for most of the Spanish broadband infrastructure but whose work is heavily regulated by government.

**Transport infrastructure**
LIGHT RAIL

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies, although certain elements of light rail projects may be outsourced to the private sector; for example, the private sector may provide new trams, run a concession or operate and maintain a light rail system on behalf of a local transport executive - the assets will continue, however, to be owned by the public sector.

HEAVY RAIL

The rail market in Spain is privatized but its composition (which is complex) involves both public and private entities.

ROADS, BRIDGES AND TUNNELS

The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. In the case of tolled roads, the private sector has taken on roads/crossings on a full concession basis - namely, responsible for the design, build, financing, operation, maintenance and collection of tolls for a number of years with the main revenue stream being the collection of toll revenues from users (rather than any service payments from the public sector) but these types of projects are no longer considered viable as the private sector is not willing to take ‘demand risk’ in order to service the upfront capital costs and associated bank debt.

AVIATION

Commercial aviation management in Spain is (for the most part) privatized. As regards airport infrastructure, there are a number of ownership structures in the Spanish market, including private ownership, local government ownership and various forms of public-private ownership. All models are heavily regulated by government and another public sector entities such as AENA, AESA and ENAIRE.

PORTS

The Spanish ports sector comprises a complex variety of public and private agents and operators. The current regulations distinguish between local ports and ports of general interest, being the latter monitored by the public bodies Autoridades Portuarias.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector. The majority of social infrastructure assets in Spain are directly financed by the government.

Education

The ownership of a school's infrastructure depends upon which category of school it belongs to. For example, in the case of a local authority maintained school, the school and playing fields will be typically owned by the local authority; an academy school can receive funding directly from the government and may lease land from a local authority.

Hospitals

More than half of the hospitals in Spain are in some way involved in the public sector: they belong to the public health and hospitals system, operate through concerted public-private actions or by means of public funds/contracts.

Social housing

This is a diverse sector involving many different organizations and individuals including housing developers, building contractors, mortgage lenders, local authorities, housing associations, landlords, owner-occupiers, private renters and those in the social rented sector, which are constrained by public sector regulations.

DEFENSE

Typically, defense assets are owned by the public sector.

Last modified 5 Dec 2019
Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in Spain over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (e.g., merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on ‘Change of Control’. This is less of a concern on private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy markets Spain have a complex system of arrangements between suppliers, generators, transmission and distribution which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customer and REE (operator of the Spanish electricity system) or ENAGAS (operator of the Spanish gas grid) and these are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice-versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.

Telecoms infrastructure

There is a complex regulatory environment for this sector including how access and interconnectors (between networks) are regulated under the General Telecommunications Law of 2003.

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

Transport infrastructure

RAIL

There is an extensive and complex regulatory framework to consider in respect of a practical and operational involvement in this sector. Key areas include understanding the regulatory regime for certification for train use and acceptance and user fare regulation. Depending on how an investor wishes to invest in a project (specifically what type of entity or asset), there is a varying degree of difficulty for investors to enter into an existing project.

ROADS

In order for a private sector partner to carry out its duties on certain types of roads projects, the procuring public sector authority may delegate certain of its statutory duties to the private sector partner. This will be dependent on the project and the specific contractual requirements. Any investor will, therefore, need to understand those duties and whether it is able to subcontract those duties to an appropriate person.

Other infrastructure

On publicly procured infrastructure, it is quite common for long-term projects to have a ‘change in control’ clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the
construction period. How strict these restrictions are will often depend on the sector. For example, the defense sector usually gives the Ministry of Defense a strong degree of discretion.

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What is the applicable procurement process?

Public procurement in Spain is, for the time being, in most instances governed by the Act 9/2017, dated 8 November, on Public Sector Contracts. There are some sector-specific regulations such as the Act 31/2007, dated 30 October, on Public Procurement in the Sectors of Water, Energy, Transports and Postal Services and the Act 24/2011, dated 1 August, on Public Sector Contracts on Defense and Security. All the regulations mentioned are based on EU Directives.

The key principles are that contract procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

Investing in energy and infrastructure

Public procurement is relevant where Spanish public sector bodies or entities, seek to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to all bodies and entities that make up the so-called ‘public sector’, conforming to the regulations of the European Directives, including all types of public administrations, autonomous agencies (organismos autónomos), state owned companies (entidades públicas empresariales), public universities and foundations, state agencies etc. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer’s bid.

- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Spain (including in relation to public-private partnerships) are as follows.

**Funding**

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders;
- bond finance; and
- asset financing (this is particularly relevant in the aviation and naval sectors).

Funding/funding products can also, sometimes, provided by the European Investment Bank and export credit agencies.

**Investing**

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, i.e., share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of ‘equity’).

Restructuring

**Enforcement and sanctions**

**When can there be regulatory investigations?**

When the Comisión Nacional del Mercado de Valores (Spanish Securities and Exchange Commission, CNMV) or the Bank of Spain considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. They may also launch a formal investigation for alleged breach of any laws and regulations applicable to entities operating in the banking and securities sector, including investigations of entities providing regulated activities without authorization or license. This may result in regulatory sanctions.

**What regulatory penalties may apply?**

When a rule breach has taken place, the Comisión Nacional del Mercado de Valores (Spanish Securities and Exchange Commission, CNMV) or the Bank of Spain may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

**What criminal penalties may apply?**

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:
fraud; insider dealing; and breaches of the money laundering regulations.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

The taking, transfer or assignment of a mortgage, debenture or other security over real estate assets located in Spain is subject to stamp duty at the tax rate approved by the Spanish region where the real estate asset is located. The applicable tax rate ranges between 0.5% and 1.5% depending on the region where the real estate asset is located.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g., a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of debt securities.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g., secured bond holders)?

In case of real estate transactions, the Spanish Tax Authorities take priority for the collection of payments of Spanish Real Estate Tax (Impuesto sobre Bienes Inmuebles) corresponding to the year of the enforcement and the four previous years. Furthermore, the Spanish Tax Authorities take priority for the collection of transfer tax and stamp duty due on previous transfers or other taxable events related to the property itself in a period of four years.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Withholding tax applies when a payment of interest with a Spanish source is paid under a loan.

If so:
What is the rate of withholding?
The current rate of Spanish withholding tax is 19%.

What are the key exemptions?

The most commonly relied on exemptions to ensure that interest payments made by Spanish companies can be made free of Spanish withholding tax include:

- the exemption for interest paid to a bank resident for tax purposes in Spain;
- reliance on a double tax treaty (such treaty may provide for a total or partial exemption); or
- reliance on the EU Interest and Royalties Directive, as implemented under Spanish domestic law, provided that certain conditions are met (the key conditions being that the lender is resident for tax purposes in a member state of the EU and is not acting through a permanent establishment in Spain nor through a territory considered as a tax haven).

Would the same analysis apply to interest payments under a debt security (e.g., a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

César Herrero
Partner
DLA Piper Spain S.L.U.
cesar.herrero@dlapiper.com
T: +34 91 790 1656
Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Swedish and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Sweden or to request that they are admitted to trading on a regulated market operating in Sweden unless a prospectus approved by the Swedish Financial Supervisory Authority (Finansinspektionen) has been made available to the public.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Sweden are bonds or notes issued on a stand-alone basis or under a program. Many different types of debt securities are offered in Sweden. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities and zero-coupon securities;
- debt securities characterized by the type of issuer (investment grade or high yield bonds);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

What are the differences between offering debt securities to institutional / professional or other investors?
The Prospectus Directive (implemented in Swedish law mainly through the Financial Instruments Trading Act 1991 (Lag (1991:980) om handel med finansiella instrument) does not make a distinction between professional and other investors for the purposes of its disclosure requirements but does include different disclosure regimes by reference to the minimum denomination of a single security.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the ‘wholesale’ rules apply. If the denomination is under €100,000, the ‘retail’ rules apply. Additional disclosure requirements apply for retail securities.

When is it necessary to prepare a prospectus?

Under the Prospectus Directive (implemented in Swedish law mainly through the Financial Instruments Trading Act 1991 (Lag (1991:980) om handel med finansiella instrument) and the Swedish Act on Supplementary Provisions to the Prospectus Directive (Lag (2019:414) med kompletterande bestämmelser till EU:s prospektförordning)), unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer would not be deemed to have been made to the public if it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per European Economic Area state or where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a Prospectus Directive compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

What are the main exchanges available?

Regulated markets

Sweden has three regulated markets for the purpose of the Markets in Financial Instruments Directive (MiFiD II), being NASDAQ OMX Stockholm (Nasdaq OMX), Nordic Growth Market NGM Equity (NGM Equity) and Nordic Growth Market Nordic Derivatives Exchange (NDX).

As a consequence of Nasdaq OMX, NGM Equity and NDX being regulated markets, issuers on these markets are subject to the requirements of a number of EU Directives, including the Market Abuse Directive and the Transparency Directive. Securities listed on these markets can be passported to other European Economic Area markets in order to access international investors.

Multilateral trading facilities (MTFs)

First North, Nordic MTF and Aktietorget are so called MTFs under MiFiD II, which means that they are not considered regulated markets and therefore provide a more flexible alternative to the requirements regarding denomination and financial information, compared to the rules which apply to regulated markets across Europe. As such MTFs permit reporting under national Generally Accepted Accounting Principles (GAAP), they offer an alternative for issuers not wishing to prepare their accounts in accordance with International Financial Reporting Standards (IFRS).

Is there a private placement market?

Sweden has an active private placement market.

There is no dominant standard for documentation but efforts have been made by the Loan Market Association and International Capital Markets Association to standardize private placement documentation.

Are there any other notable risks or issues around issuing or investing in debt
Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil liability and sanctions under Swedish law. Sweden has various statutory provisions which impose liability for an inaccurate offering memorandum and which provide investors with protection. Furthermore, general statutes regarding fraud and liability for negligence may be applicable.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretion on the agent, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investor's interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities mainly under the Securities Market Act 2007 (Lag (2007:528) om värdepappersmarknaden) and Alternative Investment Fund Managers Act 2013 (Lag om förvaltare av alternativa investeringsfonder (2013:561)) and therefore subject to regulation by the Swedish Financial Supervisory Authority (Finansinspektionen or SFSA).

Authorization from the SFSA is required in order to establish a fund. Authorization requires, inter alia, that the fund is established by a limited company incorporated in Sweden, that there are reasons to believe that the fund will be managed in accordance with the Securities Market Act 2007 and that the managers of the fund are considered suitable.

What are common fund structures?

Common forms of funds include:

- open-ended (the most commonly used in Sweden and also what is mostly referred to as a 'fund') and closed-ended funds (CEFs);
- retail and non-retail funds (including Alternative Investment Funds (AIFs));
- Undertakings for Collective Investments in Transferrable Securities (UCITS) and non-UCITS funds; and
- qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

Funds domiciled outside of Sweden mostly comprise of UCITS funds established in other jurisdictions.

What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds must be authorized by the Swedish Financial Supervisory Authority (Finansinspektionen).
Retail funds, including UCITS, are subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depositary arrangements for assets, investment and borrowing powers specifications (for open-end retail funds), concentration requirements and other matters.

Non-retail funds that are offered in Sweden generally fall into the category of Alternative Investment Funds (AIFs) and therefore are subject to the Alternative Investment Fund Managers Directive (implemented in Swedish law through the Alternative Investment Fund Managers Act 2013 (Lag om förvaltare av alternativa investeringsfonder (2013:561)) regime in relation to authorization of the manager/fund, marketing arrangements, reporting and governance etc.

**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

Separately managed accounts are also commonly used in Sweden as an investment management structure; investor funds are generally held in a separate account subject to the discretionary investment authority of a manager who can acquire and dispose of assets using the investor funds in line with a pre-determined strategy and parameters set out in an Investment Management Agreement. These are often also structured as 'funds of one'.

Managing investments is a regulated activity under the Swedish Financial Supervisory Authority's (Finansinspektionens) rules and therefore subject to authorization; however, managed accounts and 'funds of one' themselves are generally not classed as (and therefore avoid the regulatory restrictions in being classed as) Collective Investment Schemes or Alternative Investment Funds.

**Managing and marketing debt / hedge funds**

**Are there any restrictions on marketing a fund?**

**Swedish selling restrictions**

Generally in Sweden, offering securities is either covered under the Undertakings for Collective Investment in Transferable Securities Directive regime or under the Alternative Investment Fund Managers Directive regime. All Directives have been incorporated into Swedish law.

**Undertakings for Collective Investments in Transferable Securities (UCITS)**

UCITS, including those established in Sweden, have an EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

**Alternative Investment Funds (AIFs)**

Under the Alternative Investment Fund Managers Directive (implemented in Swedish law through the Alternative Investment Fund Managers Act 2013 (Lag om förvaltare av alternativa investeringsfonder (2013:561))), marketing is defined as: a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator. Registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).
Reverse solicitation and the definition of ‘marketing’

Applicable in the context of professional investors, this is a sensitive area in Sweden and Europe generally. The Alternative Investment Fund Managers Directive generally continues to permit professional investors who wish to invest in AIFs based on their own initiative (reverse solicitation); however, the EU is currently reviewing this area during 2017 and may impose tighter requirements.

Are there any restrictions on managing a fund?

Fund management in Sweden is regulated under various statutory instruments and by the Swedish Financial Supervisory Authority’s (Finansinspektionens or SFSA) regulations. The SFSA is responsible for regulating funds, fund managers and those marketing funds and any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization.

Various restrictions arise on manager structuring/compensation and profit-sharing arrangements as a result of the regulations and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and scope and complexity of its activities. The rules impact on, among other things, reporting, equity remuneration, deferred compensation arrangements and clawback.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive (implemented in Swedish law through the Alternative Investment Fund Managers Act 2013 (Lag (2013:561) om förvaltare av alternativa investeringsfonder) and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the Undertakings for Collective Investment in Transferable Securities Directive. Registration with the SFSA involves a significant authorization process – it generally takes three to six months from completion of the application and must include:

- for the manager, information on senior personnel (must be suitable persons etc), organizational structure, policies and procedures, remuneration practices; and
- for each fund, investment strategy, constitutional documents, depositary information and disclosure requirements.

However, AIFMs based in Sweden can be exempted from full regulation on certain grounds, including managing assets under €500 million where assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers must still register with the regulator, are subject to limited reporting and it should be noted that they do not benefit from the general passporting for marketing purposes.

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in Sweden (such as a dealer) will ordinarily have to be authorized under the Securities Market Act 2007 (Lag (2007:528) om värdepappersmarknaden) if the transaction is one of the specified activities set out in the act such as:

- options;
- futures;
- swaps;
- contracts for difference; or
- rights to or interests in investments.

One of the key exclusions to the requirements above applies to persons who deal in derivatives for risk management purposes.

The European Market Infrastructure Regulation applies to all derivative transactions and requires transactions to be reported to
What are common types of derivatives?

Derivative contracts are entered into in Sweden for a range of reasons including hedging, trading and speculation. Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contracts are used in Sweden:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Sweden are:

- equity;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought, in particular, to:

- enhance transparency by requiring the provision of comprehensive information on the over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.
Lending (as such, without deposit-taking) is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the Swedish Financial Supervisory Authority (Finansinspektionen) to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to other loans. For example, there are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis; and
- to deal with borrowers who fall behind with their payments.

**Borrowing**

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

**What are common lending structures?**

Lending in Sweden can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or a syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, multi-option and revolving facilities and project facilities.

**Loan durations**

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Loan security**

A loan can either be secured, unsecured or guaranteed.

**Loan commitment**

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.
Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or on a scheduled basis (usually meaning the loan is repayable in full at maturity).

What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity and so requires the Swedish Financial Supervisory Authority's authorization.

Do the laws recognize the principles of agency and trusts?

Sweden has its own, complex principle of agency which is subject to rules under both statutory law and case law.

Sweden does not recognize the principle of trusts.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual legislation and principles, such as the following:

- Section 36 of the Contract Act 1915 (Avtalslagen), the general clause, gives the courts the ability to modify or set aside a contractual provision if the court deems the clause unreasonable. The threshold for the application of the general clause is, however, quite high.

- Section 31 of the Contract Act 1915, a provision against usury (or the practice of lending money at unreasonably high rates of interest), if applicable, will cause the affected clause or contract to be ruled as invalid.

- A contractual provision may, in accordance with general contractual principles, be modified or set aside if it is deemed to be inconsistent with one party's basic assumptions in relation to the contract, even if it is due to events subsequent to the conclusion of the contract.

Specific types of lending

An issue specific to the area of mortgage lending is whether a lender falls within the recently formed Swedish mortgage regime. The Mortgage Credit Directive, implemented in Swedish law mainly through the Act on Mortgage Credit Activities 2016 (Lag (2016:1024) om verksamhet med bostadskrediter), aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Mortgage Credit Directive applies to first and second charge mortgages. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;

- provide standard information about the mortgage to enable borrowers to compare products; and

- ensure that staff are suitably trained.

Standard form documentation
Most Swedish law syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA). In general, the documentation has been adopted for Swedish purposes and is not as comprehensive as the English law equivalents. Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

**Are there any other notable risks or issues around borrowing?**

Borrowers should be aware of the potential implications of the EU’s Bank Recovery and Resolution Directive (BRRD), which has been implemented into Swedish law and outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to ‘bail in’ obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. ‘Bail in’ describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Swedish or other EEA law contracts, such powers override what the contracts say. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

**Giving and taking guarantees and security**

**Are there any restrictions on giving and taking guarantees and security?**

As a general rule, the Swedish Companies Act 2005 (Aktiebolagslagen (2005:551)) provides that all transactions of a Swedish limited liability company must provide commercial benefit for the company. In evaluating what constitutes commercial benefit, several factors shall be considered. This is primarily a factual matter rather than a legal one and it is the responsibility of the board of directors to ensure that commercial benefit accrues to the company.

Some of the key areas affecting the giving of guarantees and security are as follows.

**Insolvency**

If a company becomes insolvent, any guarantees and security given by the company may become worthless as the company will not have the monetary power to support its commitment, and they would be susceptible to being challenged in bankruptcy proceedings.

**Financial assistance**

The Swedish Companies Act 2005 (Chapter 21, Section 5) stipulates an absolute prohibition on the provision of advances, loans or security for the purposes of assisting in the acquisition of shares in the company providing the assistance or any parent company in the same group of companies. However, ‘group’ in the context of financial assistance, means a group where the parent company is Swedish.

**General upstream restrictions**

The Swedish Companies Act 2005 further stipulates that a Swedish limited liability company may not provide loans, guarantees or security to or for the benefit of anyone owning, directly or indirectly, shares in the company (including instances of cross/side-stream debt or security). The most notable exception to this rule is the group exception which provides that upstream loans and security are permitted where the debtor/beneficiary is a company in the same group as the company lending the funds or granting security. ‘Group’ in this context means a group of companies where the parent is a legal entity domiciled in the EEA.

A further exception to the upstream restrictions is where an upstream loan, or security, is provided exclusively in relation to the parent’s business operations and the company lending the funds or providing the security does so for purely commercial reasons.

Swedish law is largely silent on how commercial reasons and commercial benefit should be assessed. However, by way of example, it
would generally be possible to demonstrate commercial reasons and commercial benefit where loans are made or security is provided to an entity which is important for the lending or charging company's business. This may be the case if a loan is made to a servicing company (providing certain services to the lending company) or a group's primary trading company. A government ruling has clarified though that inter-company lending in the form of cash-pooling should be allowed and is thus considered a commercial benefit and reason.

Value transfer

In addition to the restrictions described above, it should also be noted that enforcement of upstream security in Sweden is always subject to certain restrictions which aim to protect the restricted equity of the company. Depending on the conditions on which security is given, it may be considered a value transfer to the shareholders of the company. As such, it will only be enforceable if and to the extent that:

• it is equal to or less than the unrestricted shareholders' equity (free capital reserves) of the relevant company at the time of the granting of security; and
• it is justifiable in view of the amount of equity and cash required for the running of the company's business, having due regard to the type, size and risks of the business.

The Swedish Companies Act 2005 (Arkiebolagslagen (2005:551)) provides that anyone who has received a payment which was not made in accordance with the foregoing must repay those funds.

What are common types of guarantees and security?

Common forms of guarantees

Some common forms of guarantees include:

• a tender guarantee (anbudsgaranti), which covers the buyer's loss in the event the seller refuses to sign the contract, withdraws his offer or cannot provide the required performance guarantee;
• an advance guarantee (förskottsgaranti), which covers the repayment of any advanced monies in the event that delivery does not occur;
• a performance guarantee (fullgörelsegaranti), which covers all of the seller's contractual obligations;
• a warranty guarantee (garantitidsgaranti), which covers the seller's obligations under the warranty period; and
• a payment guarantee (betalningsgaranti), which is usually issued in connection with larger building projects and consists of two parts:
  • a guarantee covering the building period; and
  • a guarantee covering the warranty period.

Common forms of security

There are four basic types of security interest that can be created under Swedish law:

• a pledge;
• a floating charge;
• a mortgage; and
• security assignment.

Different types of security are suitable for securing different types of assets.

Under Swedish law it is not possible to grant security over all of the assets of a Swedish company. A floating charge covers several types of personal property but excludes others (eg cash).
Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

A guarantee made in contravention of the rules on financial assistance, upstream loan restrictions and value transfers may entail criminal liability for the board of directors and the managing director and will render the affected guarantee invalid and unenforceable. The invalid guarantee will in such case be cancelled.

Additionally, there is a risk that a guarantee may be set aside if it was procured by undue influence by a borrower or lender.

Giving or taking security

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities vary depending on the type of security and the type of secured asset, but can either entail: a requirement for the secured asset to be delivered to the security holder (tradition) (the Non-Recourse Principle); registration of the security in a certain registry; or notice being given to a third party.

The Non-Recourse Principle is the main rule and means, \textit{inter alia}, that any pledged asset (or any instrument representing such asset) must be physically surrendered to the pledgee. In cases where the relevant asset or right is in the possession, or otherwise under the control, of a third party (e.g. a bank in the case of a bank account), notification must be given to the third party with a stipulation that the pledgor may not dispose of, or be granted access to, the pledged asset or right. As a result, the Non-Recourse Principle may cause difficulties with regards to the perfection of security under Swedish law as removing any assets from the pledgor’s control may cause operational disruption to the pledgor’s business and its continuation.

As with guarantees, when security is granted in contravention of the rules on financial assistance, upstream loan restrictions and value transfers, the board of directors and the managing director may face criminal liability and the affected security may be rendered invalid and unenforceable.

There are no notarization requirements for security documents under Swedish law.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

- Act Regarding Issue of Covered Bonds 2013 (\textit{Lag om utgivning av säkerställda obligationer (2003:1223)})

Penalties for Market Abuse on the Securities Market Act 2016 (Lag (2016:1307) om straff för marknadsmissbruk på värdepappersmarknaden)

Act on Supervision over Credit Institutes and Securities Companies 2014 (Lag (2014:968) om särskild tillsyn över kreditinstitut och värdepappersbolag)

Marketing Practices Act 2008 (Marknadsföringslag (2008:486))

**Consumer credit**

Consumer Credit Act 2010 (Konsumentkreditlagen (2010:1846))

Act Concerning Certain Activities with Consumer Credits 2014 (Lag (2014:275) om viss verksamhet med konsumentkrediter)

Credit Reporting Act 1973 (Kreditupplysningslag (1973:1173))

**Mortgages**

Act on Mortgage Credit Activities 2016 (Lag (2016:1024) om verksamhet med bostadskrediter)

Mortgage Credit Directive (2014/17/EU) (mortgage credit)

**Corporations**

Companies Act 2005 (Aktiebolagslagen (2005:551))

Partnership and Non-registered Partnership Act (Lag (1980:1102) om handelsbolag och enkla bolag)

**Funds and platforms**

Swedish UCITS Act 2004 (Lag (2004:46) om värdepappersfonder)

Alternative Investment Fund Managers Act 2013 (Lag om förvaltare av alternativa investeringsfonder (2013:561))


**Other key market legislation**

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)

Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)


*Last modified 22 Jan 2020*

**Regulatory authorization**

**Who are the regulators?**

The Swedish Financial Supervisory Authority (Finansinspektionen or SFSA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets. The SFSA is also the prudential regulator for many firms and is responsible for the regulation of systemically important financial institutions, including banks, insurers and major investment firms.
What are the authorization requirements and process?

Depending on the type of firm, a firm must apply to the Swedish Financial Supervisory Authority (Finansinspektionen) for authorization.

The regulator must assess whether the application meets the requirements. Depending on the type of application, this will be done within 45 days to five months of the submission of a complete application.

The application fee depends on the type of application ranging from SEK600 to SEK720000.

What are the main ongoing compliance requirements?

Threshold requirements (such as having adequate resources and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and loss of regulated status.

What are the penalties for failure to be authorized?

The Swedish Financial Supervisory Authority (Finansinspektionen) takes action against companies operating in the financial markets without the proper authorization by ordering the company to cease operations. The order may be coupled with a fine.

Regulated activities

What finance and investment activities require authorization?

Generally

Generally, a company which offers financial services aimed to the public must be authorized by the Swedish Financial Supervisory Authority (Finansinspektionen), unless there is an applicable exemption. The requirement for authorization is contained in different pieces of legislation depending on the type of business.

The Banking and Financing Act 2004 (Lag (2004:297) om bank och finansieringsrörelse) is generally applicable to banking and financing business, which includes:

- payment services via general payment systems;
- the receipt of funds which are available to the creditor within 30 days of demand; and
- commercial operations which involve the acceptance of repayable funds from the public, the granting of loans, the provision of guarantees for loans or, for financing purposes, the acquisition of claims or the granting of rights to use personal property (ie leasing).

Consumer credit

A company which gives or processes consumer credit must be authorized by the Swedish Financial Supervisory Authority (Finansinspektionen), unless the company is authorized under any other legislation or if the business is exempt from authorization.
Are there any possible exemptions?

There are exemptions available for certain entities and for certain types of financing activities, as listed in Chapter 2, Section 2 and 3 of the Banking and Financing Act 2004 (Lag (2004:297) om bank och finansieringsrörelse), which mean that such entities and activities can be undertaken without authorization. Exemptions include certain activities by licensed foreign undertakings, intra-group loan activities and financings in connection with the sale of certain goods or services.

Lending as such does not require a license unless it involves deposit-taking. But other rules may become applicable, such as payment services etc.

There are also exemptions available for certain consumer credit-related activities, as listed in Section 5 of the Act Concerning Certain Activities with Consumer Credit 2014 (Lag (2014:275) om viss verksamhet med konsumentkrediter), which are similar to the exemptions in the Banking and Financing Act 2004 but which also include an exemption for legal entities engaged in small-scale business that involves the provision of credit to consumers but not with a view to making a profit.

Do any exchange controls or other restrictions on payments apply?

Sweden does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in and out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

There may also be anti-money laundering and tax considerations to take into account.

What are the rules around financial promotions?

A financial promotion is a communication of an invitation or inducement to engage in investment activity made by a person in the course of business. The Swedish Financial Supervisory Authority (Finansinspektionen) has developed regulations with regards to financial promotions. Such promotions must, amongst other things, represent a balance between the opportunities and risks of investment. If a company does not comply with the regulations, the SFSA may impose sanctions.

Pursuant to the Consumer Credit Act (Sw. konsumentskreditlagen (2010:1846) there are certain information requirements that need to be met when consumer credits are marketed to the public. The requirements are, inter alia, that consumers are adequately informed about the risks of entering into the credit agreement and informed of whether the credit at issue is to be deemed a "pay day loan" (Sw. högkostnadscredit) under the Consumer Credit Act.

Furthermore, the Marketing Act 2008 (Marknadsföringslagen) has general provisions regarding marketing which must be adhered to.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are limited companies, limited partnerships and economic associations (ekonomiska föreningar). Limited companies and economic associations are body corporates with separate legal personality and with limited liability of their members. Limited partnerships are body corporates with separate legal personality, which require at least one general partner with
unlimited liability.

Limited companies can either be private or public (denoted by the suffix AB or Aktiebolag, with the addition of the suffix (Publ) for public companies) depending on whether their shares are offered to the public.

Generally, the shareholders of a limited company are not liable for the company’s debts, although in some circumstances the rights and liabilities of the company may be treated as the rights and liabilities of the shareholders.

Limited partnerships are similar to limited companies in many ways, with the main difference being that they are:

- formed by partners whose relationship is governed by private agreement; and
- taxed like a partnership.

Funds

Investment funds are limited companies which have been authorized by the Swedish Financial Supervisory Authority (Finansinspektionen).

Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A company can conduct lending or investment business in Sweden through an establishment/branch (filial). An establishment/branch is not a separate legal entity.

Overseas companies that have a Swedish establishment/branch need to comply with Swedish legislation which imposes registration, accounting, disclosure and other requirements. Overseas companies also need authorization by the Swedish Financial Supervisory Authority (Finansinspektionen).

Overseas companies carrying on a trade in Sweden through a ‘permanent establishment’ will be subject to Swedish corporation tax.

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
consumer loans;
student lending products;
small and medium-sized enterprises (SME) lending; and
residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P)-type structures, often operated through an electronic platform provider as well as crowdfunding and also direct to retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate the growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt, this will typically result in the platform being treated as a securitization for the purposes of the European Union Capital Requirements Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database, operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features, such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions, which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.
Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned'). Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form, or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question, if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security, or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:
- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of the underlying technology;
- amount of coin or token that is reserved, or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

_Artificial intelligence and robo advisory systems_

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

The Swedish Financial Supervisory Authority (Finansinspektionen or SFSA) is the regulator of conduct for firms providing financial products and services in both retail and wholesale markets.

**GENERAL**

A person must not carry on a regulated activity in Sweden unless authorized or exempt (known as the general prohibition). A financial activity requires regulatory authorization when it:

- is specified by law as a regulated activity;
- is carried on by way of business in/to Sweden; and
- does not fall within any of the available exemptions.

Where FinTech products and/or applications involve financial activity which require regulatory authorization, the firms providing such products and/or applications must be authorized by the SFSA.

**THE SFSA’S MONITORING OF THE FINTECH SECTOR**
In March 2017, the Swedish government instructed the SFSA to draft a report including:

- a survey of the players offering new innovative financial services in the Swedish financial market;
- a statement of the issues and needs that exist among their businesses;
- an explanation of what measures the SFSA can take to meet the needs of the businesses; and
- an identification of new regulation that might be required for businesses operating in this sector.

REGULATORY DEVELOPMENTS

The SFSA hosted a number of round table discussions with the FinTech sector in June 2017 and published a report on 1 December 2017 named “Fi’s role regarding innovation” (Sw. Myndighetens roll kring innovationen), at the request of the Swedish government. The European Banking Authority published a FinTech Roadmap for the years 2018-2019 which the SFSA participated in.

Electronic payment platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

Sweden does not have specific regulations for payment systems, as is the case in certain other jurisdictions. Electronic payments are governed by the Swedish Payment Services Act (Lag (2010:751) om betaltjänster), which is based on Directive (EU) 2015/2366 on payment services in the internal market (PSD II). Pursuant to the PSD II, the SFSA has issued Ordinance FFFS 2018:4.

A number of FinTech businesses are offering electronic payment platforms to rival traditional payment systems and the Swedish transposition of PSD II recognizes the increase of such business, and has been implemented in order to create a more level playing field for payment services providers, while addressing the need for enhanced security and customer protection.

The Swedish Act on Electronic Money (Lag (2011:755) om elektroniska pengar) and Ordinance FFFS 2011:49 on Electronic Money Institutions and Registered Issuers, contains a number of electronic money-related rules, directions and guidance aimed at businesses that are issuing or are considering issuing electronic money (e-money). E-money is defined as electronically stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person, other than the electronic money issuer. E-money includes pre-paid cards and electronic pre-paid accounts for use online. Generally, firms issuing e-money must be authorized or registered with the SFSA.

PEER-TO-PEER LENDERS

The act of offering or providing credit to consumers is a regulated activity (requiring authorization by the SFSA). The major peer-to-peer (P2P) lending businesses in Sweden are regulated as Consumer Credit Institutions under the Swedish Act on Certain Activities with Consumer Credits (Lag (2014:275) om viss verksamhet med konsumentkrediter) or as Payment Institutions under the Swedish Payment Services Act (Lag (2010:751) om betaltjänster).

Regulation of payment services

Where a Swedish business provides payment services in Sweden, it will require authorization by the SFSA to become an authorized payment institution under the Payment Services Act (Lag (2010:751) om betaltjänster). The regulations implement PSD II on payment services in the internal market.

In order to become authorized, a payment services provider will have to meet certain criteria related to: its business plan, initial capital, having processes and procedures in place for safeguarding relevant funds and sensitive payment data as well as money laundering and other financial crime controls.

Application of data protection and consumer laws

The European General Data Protection Regulation (GDPR) replaced the Data Protection Act from 25 May 2018. The GDPR is more prescriptive and restrictive compared to the Data Protection Act, including mandatory notifications where a breach occurs and provide for severe monetary sanctions for breach.

The Swedish Marketing Act (Marknadsföringslagen (2008:486)) also regulates unsolicited direct marketing by electronic means, in addition
to sector specific regulations, such as Ordinances issued by the SFSA.

**Money laundering regulations**

Financial institutions providing services in Sweden are obligated to comply with the Swedish Act on Measures Against Money Laundering and Terrorism Financing (Lag (2017:630) om åtgärder mot penningtvätt och finansiering av terrorism), the Act on Registration of Beneficial owners (Lag (2017:631) om registrering av verkliga huvudmän) and Ordinance FFFS 2017:11 (issued by the SFSA). These regulations implement the European Union's Fourth Money Laundering Directive. The SFSA has responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as P2P lending, providing payment services and issuing and administering other means of payment.

The SFSA supervises the firms it authorizes (including anti-money laundering requirements). Electronic currencies such as Bitcoin and cryptocurrencies tend to represent a higher money-laundering risk.

_Last modified 22 Jan 2020_

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

The crowdfunding sector is well established, and may be appropriate for the early stages of a FinTech business which is a public company (Sw. _publikt bolag_). It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or an application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses, to which they may otherwise not have had access.

**ACCELERATORS**

There are various incubators or accelerators in Sweden which offer support, facilities and funding for startups, often in return for an equity stake.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), secured against a company's assets and including an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.
Warehouse and platform funding

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms such as Lendify, Toborrow and Savelend, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments, and instead, interest is paid on the money borrowed.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Obtaining financing by way of an Initial Public Offering (IPO) is a popular funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as Nasdaq Stockholm or First North. First North in particular caters for small, growth-orientated companies.

CONVERTIBLE BONDS/LOAN NOTES

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes, which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are, under certain circumstances, convertible into shares in the issuing company at prescribed prices.

Incentives and reliefs

There are currently no incentives or reliefs that apply specifically to FinTech companies in Sweden.

SWEDISH FINTECH ASSOCIATION

The Swedish FinTech Association is a newly formed industry association for Swedish FinTech companies whose purpose is to provide a unifying platform for the Swedish FinTech community, enabling it to speak with one voice.

The association was officially formed on 17 January 2017 and it will act as a lobbyist and spokesperson within the financial industry. More information can be found here.

Last modified 22 Jan 2020

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.
The most common ways of selling loans are:

- **Assignment** – The normal way of selling loans is by way of an assignment of the rights and obligations under the loans. Subject to any contractual restrictions, assignment can be done without the consent of the debtor but it is normally prudent to ask for consent if the contract is silent on this issue.

- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller and the borrower.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association and adopted for Swedish purposes as applicable. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **Confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;

- **Data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;

- **Lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;

- **Undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

- **Transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms;

- **Perfection** – what actions must be taken to perfect the sale; and

- **Consent** – whether a transfer requires the consent or notification of any other parties.

**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Sweden varies depending on the asset class.

There are three main ownership structures:

- asset classes which are mainly wholly-owned by the state;

- asset classes that are mainly deregulated but where state/municipal companies own the assets; and

- asset classes that are deregulated and where the assets are mainly privately owned.

**Energy**

The gas and electricity industries in Sweden are partly privatized, with the generation and supply services being provided by a number of
private sector companies. The national transmission network is, however, owned by the state-owned entity Svenska Kraftnät and operates under the protection of a statutory monopoly. In the same way, regional and local distributors operate regulated monopolies which control local and regional distribution.

The Swedish energy market supervisory authority is the Energy Markets Inspectorate (Energimarknadsinspektionen). The authority supervises, among other things, the distribution monopoly and monitors network charges to ensure that they are fair.

The private sector finances and delivers most of the required infrastructure but there are a number of government policy mechanisms (adopted through legislation) which are used to incentivize investment in eligible energy generation technologies. In certain instances, including on major energy infrastructure, projects may be procured by the public sector and depending on the terms of the procurement, the asset may either be publicly or privately owned. Public-private partnerships (PPPs) are not common funders of energy infrastructure in Sweden.

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in Sweden are privately owned by a number of service providers.

Transport infrastructure

LIGHT RAIL

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies. For example, Storstockholms Lokaltrafik (SL) owns the metro (the only one in Sweden), track and supporting infrastructure in Stockholm. The metro system is maintained by MTR Tunnelbanan AB, which won the contract through a procurement process. Other light rail is similarly operated.

HEAVY RAIL

The rail market in Sweden is privatized but its composition (which is complex) involves both public and private entities. The principal elements to the rail sector in Sweden are:

- **Sveriges Järnvägar (SJ)** – Owned by the Swedish state, the company is the largest operator in Sweden.
- **Freight companies** – Freight companies are wholly commercial entities.

The rail sector is regulated by the Swedish Transportation Board (Transportstyrelsen).

ROADS, BRIDGES AND TUNNELS

The Swedish Transportation Board operates, maintains and improves the motorways and major roads in Sweden. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis but this is still very uncommon in Sweden) of such assets to the private sector. An infrastructure charge may be taken out by people using particular roads or bridges in order to finance the construction, maintenance or upgrade of the same. PPPs are not common funders of transport infrastructure in Sweden.

AVIATION

Aviation in Sweden is privatized. Ten airports in Sweden including the two largest, Stockholm Arlanda Airport and Göteborg Landvetter Airport, are run and owned by the wholly state-owned company Swedavia. The remaining two airports in Sweden, Ronneby Airport and Luleå Airport, are run and owned by other entities but Swedavia is responsible for commercial air traffic.

PORTS

Sweden has over 50 commercial ports along the coasts and in the two larger lakes. Most of them are owned by the municipal in which they are located. Others may be co-owned by private companies and the municipal, or solely privately owned. There are also privately owned industrial ports. The largest industrial port in Sweden is Brofjorden and it is privately owned by Preem.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)
All, except schools, are mainly owned and run by the public sector.

**Education**

Schools may be public or private, but are subject to Swedish law and regulations.

**Hospitals**

Hospitals are mainly owned and run by the county councils of the area in which they are located. There are private hospitals as well, and the health care at such hospitals can be financed by the county council, by the patients private health insurance or by the patients themselves. At the basic level, Sweden maintains a state-financed health care system.

**Social housing**

This is a diverse sector involving many different organizations and individuals including housing developers, building contractors, mortgage lenders, local authorities, housing associations, landlords, owner-occupiers, private renters and those in the social rented sector.

**DEFENSE**

Defense assets are owned by the public sector.

**WASTE**

The municipalities have a monopoly on and an obligation to manage the transfer of household waste. The municipalities can decide to manage the transportation by itself, through a company owned by the municipality or to hire a private operator.

**WATER**

Water services in Sweden are privatized, but with wholly state or municipal owned companies operating on the commercial market.

*Last modified 22 Jan 2020*

**Are there special rules for investing in energy and infrastructure?**

**Generally**

Private financing of infrastructure in Sweden is made through so-called OPS-projects (offentlig-privat samverkan), which are kinds of public-private partnerships. An OPS-project generally means that a project company is established to provide the infrastructure service. OPS-projects are, however, very rare in Sweden.

There is no specific regime governing or restricting investment in energy or infrastructure projects in Sweden over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal and regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses.

**Energy**

The energy markets in Sweden have a complex system of arrangements between suppliers, generators, transmission and distribution which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customer and these are subject to change and/or regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the
revocation of a license or subsidy that might make the potential target less attractive or viable.

**Telecoms infrastructure**

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

**Transport infrastructure**

**RAIL**

The railway system has, until recently, been closed off from private investments. Only recently has it been made possible for private entities to operate alongside the public. The railway system is first and foremost a state responsibility. Private investment into the railway system would require a new order of budgeting, as the current system is quite rigid.

**ROADS**

Responsibility for the roads is shared between the state, the municipals and private road associations (some of which receive government funding). As with the railway system, private investment into the road system would require a new order of budgeting, as the current system is quite rigid.

*Last modified 22 Jan 2020*

**What is the applicable procurement process?**

Public procurement in Sweden is in most instances governed by the Public Procurement Act 2016 (Lag (2016:1145) om offentlig upphandling) which is based on EU Directives.

The key principles are that contract procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

**Investing in energy and infrastructure**

Public procurement is relevant where the Swedish government, or a branch of it, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to certain public bodies including central government departments, local authorities, police and fire authorities and municipals. A regulated procurement is required where certain financial thresholds are met and, on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

In most cases, the public sector will need to publish a contract notice in the *Office Journal of the European Union* (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer’s bid.

- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been
procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Sweden (including in relation to public-private partnerships) are as follows.

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on a medium to long-term basis; such loans may later be syndicated to other funders; this is predominately a source of financing of certain energy assets;
- bond finance;
- refinancing of the debt in operational projects; and
- asset financing which is particularly relevant in the rail sector.

Funding/funding products can also sometimes be provided by the European Investment Bank and export credit agencies.

Investing

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of ‘equity’).

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Swedish Financial Supervisory Authority (Finansinspektionen) considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

What regulatory penalties may apply?

When a rule breach has taken place, the Swedish Financial Supervisory Authority (Finansinspektionen) may impose a fine or an injunction, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

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What criminal penalties may apply?

Following formal investigation, the regulators have powers to impose sanctions and fines, and in certain cases, criminal penalties, including:

- insider dealing and misleading statements and practices;
- breaches of the Anti-Money Laundering Act 2014 (Lag (2014:307) om straff för penningtvättsbrott); and
- conducting regulated activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

There are no stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Yes, the following stamp tax rates apply to mortgages over the following types of underlying property:

- real estate – 2% of the mortgage amount;
- aircrafts and businesses – 1% of the mortgage amount; and
- ships – 0.4% of the mortgage amount.

All other types of property are exempt from mortgage stamp tax.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

There are no stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security.

Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over the Swedish Tax Agency on enforcement of security.

Is withholding tax on interest payments applicable?
Is there withholding tax on interest payments under a loan?

There is no withholding tax on interest payments.

If so:
What is the rate of withholding?

N/A.

What are the key exemptions?

N/A.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Henrik Sjorslev
Partner
DLA Piper Denmark Law Firm P/S
henrik.sjoerslev@dlapiper.com
T: +45 33 34 03 04
Thailand

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

Generally, restrictions on the issuance of debt securities is dependent on the types of debt securities to be issued. For example:

- **Bonds / debentures and notes** – A private limited company can issue bonds/debenture subject to approval from the SEC. A public limited company can issue bonds/debentures, convertible bonds/debentures, notes and structured notes with filing and/or approval as well as report requirements by the SEC.

- **Basel III Subordinated debt instruments** – An issuer must be a financial institution under the Financial Institution Act B.E. 2551 (2008). A branch of a foreign commercial bank (although categorized as a financial institution under Thai laws) is not allowed to issue Basel III Subordinated debt instruments.

A foreign company can offer a sale of its bonds and/or debentures in Thailand and may be exempt from certain duties (eg the duty to file certain documents and a prospectus) if the foreign debt securities are offered to not more than ten investors within four months as this would be deemed a private placement.

Thai companies, foreign companies and certain entities under foreign laws (eg a unit or organization of foreign government, international organization and legal entities established under foreign laws and supervised by an authority which is a member of the International Organization of Securities Commissions) can issue bonds denominated in a foreign currency in Thailand provided the issuing entity complies with the relevant filing, approval and reporting requirements of the SEC.

What are common issuing methods and types of debt securities?

There are two major types of debt securities recognized under Thai law, being bonds / debentures and bills / notes, including:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (ie debt securities that have no specified redemption date);
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rates, currency rates or indexes;
- equity-linked securities such as convertible debentures (ie debt securities convertible into the equity of the issuer); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).
What are the differences between offering debt securities to institutional/professional or other investors?

Under the laws of Thailand, offering debt securities to institutional/professional or other investors is differentiated by whether the offering is by way of private placement or public offering.

A private placement of debt securities can be made by way of:

- limited offer of debentures:
  - to not more than ten investors within a four month period – calculation of investors will base on the actual beneficiary whose shares may be held via broker, dealer or underwriter;
  - to Institutional Investors;
  - to High Net Worth (HNW) Investors regardless of whether the offer is made to Institutional Investors or not;
  - to existing creditors for purpose of a debt restructuring;
  - which are made with specific relaxation from the Securities and Exchange Commission (SEC); or

- limited offer of bills:
  - to Institutional Investors (short-term bills);
  - to High Net Worth (HNW) Investors whereby an issuer shall be a financial institution, securities company or a life insurance company regardless of whether the offer is made to Institutional Investors or not (short-term bills); or
  - to limited to persons related to the issuer which does not exceed 10 bills at any time.

For the purposes of the above:

- 'Institutional Investors' means specific institutional investors, e.g. finance companies, securities companies, insurance companies and mutual funds.
- 'HNW Investors' means a juristic person or a natural person having shareholdings or investments in securities or derivatives contracts reaching the amount specified by the Securities and Exchange Commission (SEC), as follows:
  - for a juristic person HNW – shareholders' equity of at least THB100 million, or direct investment in securities of at least THB20 million or at least THB40 million (including deposits) based on the latest audited financial statements; and
  - for a natural person HNW – net assets of at least THB50 million (excluding main residence), annual income of at least THB4 million, or funds for direct investment in securities of at least THB10 million or at least THB20 million (including deposited funds).

The laws of Thailand also make a distinction between the offering of securities by Thai and non-Thai issuers.

The main distinction between the offering of debt securities by private placement or public offering largely concerns approval and disclosure requirements.

The public offering of debt securities requires the approval of the SEC, rating requirements and detailed disclosure and reporting requirements. Private placement is simpler as rating requirements and approval from SEC are not normally required.

When is it necessary to prepare a prospectus?

Subject to certain exemptions, submission of a draft prospectus is generally required upon offering of debt securities. Exemptions includes, for example:

- offering debt securities to investors outside Thailand;
• offering newly issued bonds/debentures without transfer restriction by way of limited offer or to institutional investors established under foreign laws; and
• offering debentures with certain conditions specified by the Securities and Exchange Commission (SEC).

What are the main exchanges available?

Apart from the primary market in which debt securities are traded after issuance, the Thai Bond Exchange (TBX) regulated by the Stock Exchange of Thailand is the main exchange platform. The TBX enhances the bond secondary market. Prior to the TBX, bonds were traded over-the-counter among the institutional investors. Currently, only bonds issued by publicly listed companies are allowed to be traded on the TBX.

An investor seller needs to open an account with a member of the TBX or a brokerage company in order to sell and purchase securities. Investors submit orders to sell or purchase through such members or brokerage companies who will forward such order into the exchange platform. Automatic Order Matching is applicable to match orders of sale and purchase of debt securities.

Is there a private placement market?

There is a limited private placement market in Thailand.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liabilities under regulations of the Securities and Exchange Commission and other applicable laws.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the Securities and Exchange Act B.E. 2535 (1992) (SEA) and therefore subject to regulation by the SEC and the SET.

The mutual fund for Institutional Investors and Ultra High Net Worth (UHNW) Investors under the supervision of the SEC are similar in nature to hedge funds (eg no investment restrictions on the type of financial assets, no ratio requirements on investment). The mutual fund set up for this investment purpose must not be a retirement mutual fund, ETF fund or long term equity fund.

Investment made by mutual funds must comply with the governing rules and investment policy specified in the prospectus. The investment policy must be risk diverse in terms of assets, industrial sector and in line with investment restrictions, if any.

For the purposes of the above:

• ‘Institutional Investors’ means specific institutional investors, e.g. finance companies, securities companies, insurance companies and mutual funds.
• ‘UHNW Investors’ means a juristic person or a natural person having shareholdings or investments in securities or derivatives contracts reaching the amount specified by the SEC, as follows:
• for a juristic person UHNW – shareholders' equity of at least THB200 million, or direct investment in securities of at least THB40 million or at least THB80 million (including deposits) based on the latest audited financial statements; and

• for a natural person UHNW – net assets of at least THB70 million (excluding main residence), annual income of at least THB10 million or THB7 million (excluding spouse's income), or funds for direct investment in securities of at least THB25 million or at least THB50 million (including deposited funds).

**What are common fund structures?**

Common forms of funds include:

• open-ended and closed-ended funds; and

• retail and non-retail funds.

**What are the differences between offering fund securities to professional / institutional or other investors?**

**Retail funds**

Retail funds are known as mutual funds under Thai law. Open-ended retail funds or close-ended retail funds must be authorized and supervised by the SEC and the SET.

Retail funds are subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depositary arrangements for assets, investment and borrowing powers specifications (for open-ended retail funds), concentration requirements and other matters.

**Institutional / professional funds**

Non-retail funds are known as private funds under Thai law and are subject to authorization and supervision by the SEC. Private funds are described in detail in [Entity establishment](#).

**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

Risk can emanate from a fund manager’s failure to comply with laws, rules, regulations, prescribed practices, internal policies, procedures or prospectus rules approved by the SEC.

For property funds or Real Estate Investment Trusts, foreign investment limits will apply. Not more than 49% of all purchased investment units can be held by foreign investors. In addition, the SEC also requires the registrar to oversee the ratio of foreign investment units and to reject any transfer of units resulting in the violation of foreign investment limits.

**Investing in funds**

Apart from usual commercial risks, there are no notable risks associated specifically with investing in funds in Thailand.

**Managing and marketing debt / hedge funds**
Are there any restrictions on marketing a fund?

Marketing and advertisements must not contain any misleading or false information. The asset management company (which must be approved and licensed by the SEC) must provide investors with appropriate services and complete information relating to the funds and investments, especially if the funds have special features. Any information disclosed for the purposes of marketing or advertisement of investment products (including securities and derivatives contracts as well as funds and collective investment schemes established under foreign law) will be subject to the regulations of the SEC.

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Are there any restrictions on managing a fund?

The asset management company must have a reliable operational system that supports segregation of duties, compliance, risk management, recruitment and monitoring of business operations. The systems should also strengthen efficiency of internal control and recordkeeping for audit trails, and enforce information barriers to safeguard non-public information that could cause conflicts of interest.

The asset management company must conduct due diligence and implement an efficient policy and procedure to prevent conflicts of interest covering at least the following areas:

- affiliated transaction;
- proprietary trading;
- front running;
- staff dealing; and
- soft dollar / rebate.

Personnel in the asset management company must be qualified under Securities and Exchange Commission regulations.

An asset management company can operate other business only if such other business will not cause risk to clients’ assets or create a conflict of interest with its securities business and provided that it will support its fund management activities.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

A person, being a natural person or a legal entity, operating derivatives business in Thailand will ordinarily have to be authorized under the Derivatives Act B.E. 2546 (2003).

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What are common types of derivatives?

Common types of derivatives traded in Thailand include:

- forwards, being contracts in which one party is obliged to deliver goods as specified in the contract to the other party at a given time in the future, and the other party, in turn, is obliged to make payment for such goods at a price specified therein;
- futures, being contracts in which one party is obliged to make payment to the other party, or vice versa, in the amount which is equivalent to the difference between the price or value of goods or other variable specified in the contract and the price or value of such goods or variable prevailing at a given time or period of time in the future as specified in the contract; and
- swaps and options, being contracts in which one party is entitled to demand the other party delivers goods, or makes payment for goods, or makes payment in the amount which is equivalent to the difference between the price or value of goods or variable specified...
in the contract and the price or value of such goods or variable prevailing at a given time or period of time in the future as specified in
the contract, or to demand the other party enters into any of the contracts described above.

Derivatives may be traded over-the-counter or on an organized exchange, being the Thailand Futures Exchange (TFEX).

Permitted underlying assets in respect of which futures and options may be traded on the TFEX include:

- **equities** – stock indexes and individual stocks;
- **debt instruments** – bonds and interest rates;
- **commodities** – precious metals, base metals and energy; and
- **other indexes** – exchange rates, commodity indexes and others as may be announced by the Securities and Exchange Commission.

Currently, products available in Thailand include SET50 Index Futures, SET50 Index Options, Single Stock Futures, Gold Futures, Interest Rate Futures, USD Futures and Sector Index Futures.

The Bank of Thailand also regulates and supervises certain types of over-the-counter financial derivatives conducted by financial institutions.

**Are there any other notable risks or issues around entering into derivatives contracts?**

The Thai derivatives market has developed in recent years. Significant regulatory focus has been placed on transparency and minimizing counterparty defaults in over-the-counter derivatives in particular. The Bank of Thailand has also implemented Basel III.

Since 2010, Thai law has recognized the derivative warrant, which is an instrument that gives the holders rights to buy and sell underlying securities or the right to earn profits from derivative warrant prices or an underlying asset’s index. The SEC allows only derivative warrants with securities as the underlying asset. The issuer of a derivative warrant must be a third party and not the listed company issuing the underlying securities.

Generally, there are two types of derivative warrant as follows.

**Non-collateral derivative warrant**

The risk of this derivative warrant will be the issuer’s obligation to deliver the underlying securities or pay the differences. The SEC will consider the issuer’s risk management, financial condition and operating system as criteria for granting approval for offering of non-collateral derivative warrants. Issuers can be securities companies or commercial banks having in place robust risk management systems, financial stability and effective controls operations.

**Collateral derivative warrant**

The risk of this derivative warrant will depend on the collateral, not the issuer’s risk management. The SEC will consider the safekeeping of the underlying securities by trustee, as specified by the Trust for Transactions in Capital Market Act B.E. 2550 (2007).

**Debt finance**

**Lending and borrowing**

**Are there any restrictions on lending and borrowing?**

**Lending**

Lending is generally not a regulated activity unless the lending activity ordinarily carried out by certain business operators such as the
financial institution, securities company or regulated non-bank business operators providing consumer-related loans eg personal loan, nano finance and credit card business which is regulated by BOT or pico finance which is regulated by the FPO.

The general restrictions on lending relate to interest rate and debt collection activities. The maximum interest rate for lending is 15% per annum unless certain cases apply such as a loan provided by financial institutions or a consumer loan. Violation to the maximum interest rate could result in voidance of the interest rate plus separate criminal penalty.

Under Thai law, directors have a general duty to apply the diligence of a careful businessman in their conduct of a company's business. Adequate corporate benefit must be shown by the directors to derive from the company lending or that such lending is for the best interest of the company and necessary in the ordinary course of the business. The safe approach is often to have the members of the company approve the lending by resolution.

**Borrowing**

Borrowing is not a regulated activity. However, borrowing limits may apply in certain situations. For example, if the borrower has been granted certain incentives, such as under the promotional investment scheme of the Board of Investment of Thailand or it has obligations regarding financial indebtedness under contractual agreements.

If the borrower is a retail consumer, the borrower will benefit from protections under certain laws concerning personal loans, nano finance, pico finance and consumer protection.

**What are common lending structures?**

Lending can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities.

**Loan durations**

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Loan security**

A loan can either be secured, unsecured or guaranteed.

**Loan commitment**

A loan can also be:
• committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

**Loan repayment**

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

The laws of Thailand do not allow accrued interest to be capitalized to the principal amount unless the interest has been in default for at least one year and compound interest is prohibited. Therefore, the principal amount of a loan is generally structured to be due and payable in full at the maturity date or on demand, while the interest and other payments will generally be due and payable periodically or upon occurrence of certain trigger events. The relevant statutory limitation periods are five years for loan instalment repayments and ten years for scheduled repayments of loans in full at maturity.

*Last modified 4 Apr 2020*

**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional and/or professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of consumer lending is a regulated activity under the supervision of Bank of Thailand and Fiscal Policy Office.

*Last modified 4 Apr 2020*

**Do the laws recognize the principles of agency and trusts?**

Only the agency concept is recognized under Thai law.

*Last modified 4 Apr 2020*

**Are there any other notable risks or issues around lending?**

**Generally**

Loan agreements and other finance documents are subject to specific provisions under the Civil and Commercial Code of Thailand.

Agreements are also subject to general contractual principles, rules regarding excessive interest rates and consumer protection law. In certain circumstances, breach of these rules is a criminal offence.

As noted above, if the business operator providing lending as non-banks is a foreign majority owned company, a foreign business license/certificate is needed to be granted by the Ministry of Commerce.

**Standard form documentation**

There is no legally required standard form documentation.

While it has become common practice to use the standard form loan agreements recommended by the Asia Pacific Loan Market Association (APLMA), it is prudent for such forms to be amended by a Thai-qualified lawyer as there are material concepts and provisions in the APLMA forms which are not recognized or suitable under Thai law.

*Last modified 4 Apr 2020*

**Are there any other notable risks or issues around borrowing?**
The laws of Thailand do not allow accrued interest to be capitalized to the principal amount unless the interest has been in default for at least one year. Compound interest is also prohibited under Thai Law.

From a borrower's perspective, if the borrower has paid to the lender interest at a rate which is not permissible under the laws of Thailand, the borrower cannot later claim or bring an action against the lender for a refund from the lender of such overpayment of interest.

From the lender's perspective, pursuant to the Excessive Interest Rate Prohibition Act B.E. 2560 (2017), excessive interest rates and the use of structured payments or arrangements to conceal the use of excessive rates of interest are prohibited and subject to both civil and criminal sanctions.

If a foreign majority owned company which is incorporated in Thailand provides a guarantee or use its assets as collateral to secure loans either in Thailand or outside Thailand, a foreign business license/certificate is additionally needed to be granted by the Ministry of Commerce for the provision of security.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors’ powers that would be preventative. Under Thai law, directors have a general duty to apply the diligence of a careful businessman in their conduct of the company's business; as such, they will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security or that such guarantee or security granted as it is necessary in the course of ordinary business of the company and the best interests of the company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution, however, shareholders are generally able to ratify the actions of the company directors. Thai law does not prohibit upstream guarantees and therefore guarantees may be provided by a subsidiary to guarantee the performance of its parent company obligations provided such action is contemplated in the company's objectives.

Insolvency

Guarantees and security may be at risk of being set aside under Thai insolvency laws if the guarantee or security was granted by a company within a certain period of time prior to the onset of insolvency. This would be the case if the company giving the guarantee or security received considerably less consideration, and as such, the transaction was at an undervalue. If such undervalued transaction is made within the period of one year prior to the insolvency petition or after that, it can be revoked. If the company provides security with an aim to give advantage to one creditor over other within three months before the insolvency petition or thereafter, such security can be revoked. If fraudulent motive can be shown, the company and/or its directors may be liable for a fine and / or imprisonment.

What are common types of guarantees and security?

Common forms of guarantees

According to the CCC, a guarantee can secure the performance and payment of principal obligations which must legally valid. A guarantee must be made in writing in order for it to be used as evidence in court proceedings and only an original signed version may be used as evidence in such proceedings.

Common forms of security
There are three basic types of security interest that can be created under Thai law:

- a pledge under the CCC;
- a mortgage under the CCC; and
- a business security under the Business Security Act B.E. 2558 (BSA); and
- a leasehold right under the Leasehold Right in Immovable Property Act B.E. 2562 (LRIPA).

A mortgage may only be taken over immovable property and certain registrable movable property, e.g. registered machinery, ships of five tons and over, floating houses and beasts of burden (i.e. elephants, horses, cows, buffalos, mules and donkeys). A pledge, on the other hand, is available only for movable property.

Business security is a new security interest recognized under Thai law which may be granted by a legal entity or a natural person over its business, including all property relating to such business. Collateral under BSA includes:

- the business itself;
- its claims;
- movable property that the security provider uses in its business operation (e.g. machinery, inventory or raw materials);
- immovable property if the security provider operates a business involving immovable property (e.g. property development business); and
- intellectual property.

In addition to the business security, a leasehold right in immovable property is recently upheld as another class of asset under the new law, i.e. LRIPA which is aimed to increase the economic possibilities of the leased property and investment of immovable properties and growth in Thai economy.

Under the LRIPA, the registered leasehold right can be transferred and used as security, for example, an owner of the property who registers the leasehold right over such property is able to transfer such leasehold right to the lessee and the lessee can utilise such leasehold right as if they are the owner of the immovable property. The 30-year period is the maximum leasehold right duration permissible under the LRIPA.

Are there any other notable risks or issues around giving and taking guarantees and security?

If a guarantor is a company, it must have an express or ancillary power to provide a guarantee or security to secure the debt of another person. A foreign owned company must hold a foreign business license in order to provide a guarantee or security to secure debt of another person.

Giving or taking guarantees

- The guaranteed obligation, objectives and type of obligation, maximum amount of guarantee and period of time that such obligation will be incurred must be expressly specified unless the guarantee is in respect of a series of transaction which can be terminated at the sole discretion of the guarantor by informing the creditor.
- An agreement results in the guarantor being jointly liable with the debtor or as primary debtors is void unless the guarantor is a legal entity who agrees to such joint liability.
- The creditor must notify the debtor's default to the guarantor in writing within 60 days of default, otherwise the guarantor will be released from its obligations in respect of the guaranteed interest, damages and other charges arising from the lapse of such 60 days.
- The liability of the guarantor will be discharged once the obligations of the debtor are extinguished.
- Advance consent granted by the guarantor for any extension of the guarantor’s obligation or the guarantee period is not enforceable under Thai law.
The above-mentioned provisions are mandatory under Thai Law and cannot be agreed otherwise by the parties as such terms will be void or unenforceable. The guarantor is not allowed to provide a mortgage of the guarantor’s assets to secure another person’s debt with the condition to be liable for the deficit amount after the enforcement of mortgaged property unless (i) such other person is a legal entity, (ii) the mortgagor is a director or a controlling person of such legal entity and (iii) the guarantor separately enters into a guarantee agreement. The purpose of this provision is to limit the liability of the mortgagor to only the mortgaged asset, so that the mortgagor will not have to be liable for the deficit of the outstanding debt of another person. Under Thai law, the mortgagor will not be liable for the deficit amount of money at the time of enforcement, if it is a mortgage to secure another person’s debt. Therefore, the exemption will apply if the mortgagor / guarantor is the director or the controlling person of the legal entity who is a primary debtor.

Guarantees can be made either at the time of entering into the underlying obligation or after that.

It should be noted that if a creditor rejects the requests of a guarantors to perform the guaranteed obligations once such obligations are due, the guarantor will be released from its liability.

Giving or taking security

PLEDGE

• Physical possession of pledged property is required to perfect a pledge. As a result, the pledge will be terminated once the pledged property is returned into the possession of pledgor.

• Shares in a company can be pledged but it will only be enforceable against third parties once such pledge is recorded in the share register book of the company whose shares are pledged. A pledge of transferable instruments eg notes must be endorsed on the pledged instrument.

• Prior to enforcement of a pledge, the pledgee must notify the pledgor in writing within a specified period of time unless the pledged property are notes.

• A pledge is enforced by the selling the pledged property at public auction and the pledgee must notify the pledgor of the date and time of such sale.

• The pledgor is liable for the deficit amount of money after the enforcement of pledged property.

MORTGAGE

• A mortgage is required to be made in writing and registered with the relevant authority, e.g. the local land office is the registry for land mortgage and the Office for Machinery Registration is the registry for mortgage on machinery, otherwise the mortgage will be void.

• The means of enforcement of a mortgage is limited only to selling the mortgaged property at public auction or to foreclose the mortgaged property.

• Prior to enforcement of a mortgage, the mortgagee must provide the debtor and the mortgagor at least 60 days' notice in writing to perform the obligation.

• The mortgagor will not be liable for any deficit amount of money following enforcement of the mortgage, if the mortgage is granted to secure other person’s debt.

Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally
Civil and Commercial Code of Thailand


Payment System Act B.E. 2560 (2017)


**Consumer credit**

Civil and Commercial Code of Thailand

Credit Information Business Act B.E. 2545 (2002)

Consumer Protection Act B.E. 2522 (1979)

MOF Notification re Business Subject to Approval to Clause 5 of the Revolutionary Council Decree 58 as amended

MOF Notification re Business Subject to Approval to Clause 5 of the Revolutionary Council Decree 58 (Regulated Personal Loan) as amended

MOF Notification re Business Subject to Approval to Clause 5 of the Revolutionary Council Decree 58 (Regulated Nano Finance) as amended

MOF Notification re Business Subject to Approval to Clause 5 of the Revolutionary Council Decree 58 (Pico Finance) as amended

MOF Notification re Business Subject to Approval to Clause 5 of the Revolutionary Council Decree 58 (Regulated Peer-to-Peer Lending Platform Business)

**Mortgages**

Civil and Commercial Code of Thailand


**Corporations**

Civil and Commercial Code of Thailand

Public Limited Companies Act B.E. 2535 (1992)

Foreign Business Act B.E. 2542 (1999)

Investment Promotion Act B.E. 2520 (1977)

**Funds and platforms**


Emergency Decree on Digital Asset Business B.E. 2561 (2018)

Ministerial Regulations - Approval for operation of securities business B.E. 2551 (2008)

Notification of the Office of the Securities and Exchange Commission No. SorNor. 87/2558 - Criteria, conditions and method of management of Mutual Funds for General Investors, Mutual Funds for Non-Retail Investors, Mutual Funds for Institutional Investors and Private Funds

Notification of Capital Market Supervisory Board No. TorNor. 88/2558 - Establishment of Mutual Funds for General and Non-Retail Investors and Execution of Agreements for Private Fund Management

Notification of Capital Market Supervisory Board No. TorNor. 89/2558 - Criteria for management of Mutual Funds for General and
Non-Retail Investors and Mutual Funds for Institutional Investors and Private Funds

Notification of the Securities and Exchange Commission No. KorNor. 19/2540 (criteria, conditions and method of establishment of property fund for institutional investors)

Notification of Capital Market Supervisory Board No. TorNor. 73/2552 (criteria, conditions and method of establishment of funds for foreign investors)

Notification of Capital Market Supervisory Board No. TorNor. 38/2562 (criteria, conditions and method of establishment and management of infrastructure funds)

Notification of Capital Market Supervisory Board No. TorNor. 42/2555 (criteria, conditions and method of establishment and management of carbon funds)

Notification of the Securities and Exchange Commission No. KorNor. 22/2545 (criteria, conditions and method of management of venture capital funds)

Notification of the Office of the Securities and Exchange Commission No. KorJor. 15/2561 (Public Offer for Sale of Digital Tokens)

Notification of the Office of the Securities and Exchange Commission No. KorJor. 12/2562 (Private Placement Offer for Sale of Digital Tokens)

Notification of Capital Market Supervisory Board No. TorJor. 21/2562 (Regulations on Offer for Sale of Securities through Crowdfunding System)

Notification of Capital Market Supervisory Board No. TorJor. 1/2563 (Public Offer by a Private Limited Company Social Enterprise)

Notification of Capital Market Supervisory Board No. TorJor. 17/2563 (Private Placement Offer by SMEs)

SEC Guidelines on Issuance and Offer for Sale of Green Bond, Social Bond and Sustainability Bond

Other key market legislation


Notification of the Securities and Exchange Commission No. KorKor. 9/2552 (criteria of approval and approval to operate as trustee)

Notification of Capital Market Supervisory Board No. TorJor. 39/2559 (approval for sale of newly issued shares)

Notification of Capital Market Supervisory Board No. TorJor. 17/2561 (approval for sale of newly issued debt instruments)

Notification of Capital Market Supervisory Board No. TorJor. 49/2555 (issuance and sale of trust unit of Real Estate Investment Trust)

Notification of Capital Market Supervisory Board No. TorJor. 12/2558 (issuance and sale of units of Infrastructure Trust)

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Regulatory authorization

Who are the regulators?

The Securities and Exchange Commission (SEC) is the supervisory authority responsible for securities regulations. The remit of the SEC covers a wide range of securities-related activities and transactions in both the retail and wholesale market.

The Stock Exchange of Thailand (SET) is the supervisory authority which provides a platform for the sale and purchase of listed securities. The SET also acts as a clearing house and securities depository.

The Bank of Thailand (BOT) is the supervisory authority which regulates financial institutions, currency exchange, payment system, regulated non-banks, peer-to-peer lending and asset management.

The Ministry of Finance (MOF) oversees the SEC, the SET and the BOT. The MOF also regulates other specific finance activities, such as
credit bureau and escrow agent.

The Ministry of Commerce (MOC) overseas the business registration and the business security registration.

**What are the authorization requirements and process?**

Depending on the type of firm or the transaction, a firm or an individual must generally apply to obtain authorization from the relevant regulator and satisfy documentary requirements.

Certain activities are exempt from authorization. For instance, certain types of activity only require the satisfaction of documentary or information requirements before commencement or upon completion of a transaction. Activities exempt from authorization but which must satisfy documentary filing requirements include private placement offerings of debentures or shares, as regulated by regulations of Securities and Exchange Commission.

**What are the main ongoing compliance requirements?**

There are two main forms of ongoing compliance requirements, namely merit-based regulations and disclosure-based regulations.

**Merit-based regulations**

Ongoing compliance obligations are determined depending on the type of transaction involved, for example corporate governance requirements apply to an offering of equity securities and credit rating requirements apply when a transaction involves debt instruments.

Examples of merit based regulations include the following.

**THE CORPORATE GOVERNANCE CODE FOR LISTED COMPANIES**

The latest version of these guidelines for listed companies was issued in 2017 and contains eight main practices of good governance. Although not mandatory, compliance with good corporate governance provides reassurance for investors.

**THE INVESTMENT GOVERNANCE CODE FOR INSTITUTIONAL INVESTORS (I CODE)**

Having considered the Stewardship Code of United Kingdom, the Securities and Exchange Commission (SEC) has issued this code which sets out seven keys practices regarding investment governance of institutional investors. Similarly to the Corporate Governance Code for Listed Companies, this I CODE is not a mandatory guideline but has been encouraged by the SEC to be implemented to enhance creditability and investment environment.

**NOTIFICATION OF THE SECURITY EXCHANGE COMMISSION NO. KORJOR. 3/2560 - DETERMINATION OF UNTRUSTWORTHY CHARACTERISTICS OF COMPANY DIRECTORS AND EXECUTIVES**

This Notification sets out criteria to determine the characteristics of untrustworthy directors.

**CREDIT-RATING REQUIREMENTS**

The issuance of bonds/debentures and bills or an investment unit of funds requires a credit rating which is required to be given by approved credit rating agencies. There are currently five approved credit-rating agencies under the laws of Thailand, being Standard & Poor’s, Moodys, Fitch Ratings, Rating and Investment Information, Inc. and the Japan Credit Rating Agency, Ltd.

**Disclosure-based regulations**

Disclosure requirements depend on the nature of a transaction and the type of investors involved, for example disclosure requirements for private placement are more lenient than for initial public offerings. Disclosure of information about a company, the securities and investors are generally required. In some instances, approval must be obtained before commencement of a transaction and/or certain documentary requirements must be fulfilled upon completion.
Examples of disclosure based obligations include the following.

**EQUITY SECURITIES**

The offering of equity securities to the public requires disclosure on a strict basis. Disclosure is normally carried out by filing a form and preparing a prospectus which contains information regarding the issuer, details of securities, risks of investment.

**BONDS / DEBENTURES**

The offering of bonds / debentures requires disclosure of certain details, including the terms and conditions of the bonds / debentures, any transfer restrictions and the rights of holders of such debt instruments.

**EXECUTIVE SUMMARY**

The issuer is obliged to prepare an Executive Summary in the form required, which is attached to the subscription form for the securities. In addition, disclosures must be published on the website of the Securities and Exchange Commission and investors are encouraged to read it.

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**What are the penalties for failure to be authorized?**

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to a fine and/or imprisonment.

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**Regulated activities**

**What finance and investment activities require authorization?**

**Generally**

A person must not carry on a regulated activity in Thailand unless authorized or exempted.

A financial activity requires regulatory authorization when it is identified as a regulated activity in relation to a regulated investment and it does not fall within any of the available exemptions.

- Regulated activities include, without limitation, activities such as accepting deposits, dealing in, managing, arranging and advising on investments, and establishing collective investment schemes.

- Regulated investments include, without limitation, equity instruments, debt instruments, options, futures and units in a collective investment scheme eg mutual funds, property funds, funds for foreign investors and infrastructure funds.

**Consumer credit**

Regulated consumer credit activities include, without limitation, the operation of an electronic system in relation to credit cards, personal loans, nano finance, PICO financing, payment gateway services, electronic money, clearing house services and the settlement of payment.

Unless exempted by law, these activities can only be offered by qualified companies who are licensed and supervised by the Ministry of Finance and the Bank of Thailand.

It might be worth noting that currently there is a draft Bill on the Regulated Financial Service Providers, e.g. hire purchasing, leasing and factoring. Once this bill become enacted as an act, certain consumer financial services will become regulated services.

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Are there any possible exemptions?

There are two types of exclusions available when regulated activities may be undertaken without authorization.

**General exclusions**

Certain persons may carry on a regulated activity provided such activity does not fall into a category of operating a securities business which requires authorization. For example, providing general advice on securities investment to foreign investors or providing advice to closed groups or institutional investors may be undertaken without authorization.

**Specific exclusions**

For each type of regulated activity there are a number of specific exemptions that could also apply, such as making introductions (that is, making arrangements under which clients can, under certain circumstances, be introduced to another person).

Do any exchange controls or other restrictions on payments apply?

Yes.

The Bank of Thailand applies foreign exchange regulations to control and supervise cross-border transactions which involve foreign currencies, in particular if there will be repatriation of funds outside of Thailand.

Foreign currencies can be transferred into Thailand without limit. However, any person receiving foreign currencies from abroad is required to immediately sell such funds to an authorized bank or deposit such funds in a foreign currency account opened with an authorized bank within 360 days of receipt. Non-Thai residents and foreigners staying in Thailand for not more than three months, foreign embassies, and international organizations (including staff with diplomatic privileges) are exempt from this rule.

Antimoney laundering and tax considerations should also be taken into account.

What are the rules around financial promotions?

**Rules**

Only a securities company licensed by the SEC can contact or solicit business from or otherwise provide advice on securities investment to investors or clients.

**Exemptions**

Exemptions include solicitation to institutional investors for investment outside of Thailand. For example, a non-Thai securities company licensed by a regulator which is an ordinary member of the International Organization of Securities Commissions can solicit business from Thai institutional investors to manage investments overseas without being licensed by the SEC.

Entity establishment

**What types of legal entity are generally used to undertake financial or investment activity?**

Generally
The most common types of legal entities are private limited companies and public limited companies, both of which are body corporates with separate legal personality and limit the liability of their members to their shareholdings (i.e. shareholders are liable to pay for their shares but not the company's debts).

Limited companies can either be private (denoted by the suffix Co Ltd, Ltd or Limited) under the Civil and Commercial Code of Thailand (CCC) or public (denoted by the suffix PLC or Public Limited Company) under the CCC and the Public Limited Companies Act (PLCA). Only shares in public limited companies listed on an exchange can be publicly traded, subject to approval by the SEC.

Thai public limited companies can choose to list their shares with the Stock Exchange of Thailand (SET) or the Market for Alternative Investment (MAI) depending on its qualifications. Companies listed on the SET or the MAI are required to comply with the regulations of the SEC and the SET applicable to the main exchange or the alternative exchange, as the case may be. Foreigners may invest in listed securities using non-voting depository receipts (NVDRs) through Thai NVDR Co., Ltd. (the Thai NVDR), which is a subsidiary of the SET. The Thai NVDR was established in order to alleviate the constraints on foreign shareholding in Thai companies.

Funds

The most common type of funds used as investment vehicles for the private sector are mutual funds, private funds and provident funds.

**Mutual fund**

A mutual fund is a form of collective investment, pooled and managed by an asset management company holding a license from the SEC to undertake investment management business. A mutual fund is established as a separate legal entity from the asset management company. Mutual funds may be established for specific investment purposes and/or investors, for example property, infrastructure, carbon credit, retirement and collective investment schemes.

**Private fund and provident fund**

A private fund is formed of no more than 35 investors. It is managed by an asset management company licensed by the SEC to invest in securities or other assets according to an agreement with its investors. Unlike a mutual fund, a private fund does not have a separate legal personality. To protect the interests of its investors, the asset management company is required to appoint a private fund manager approved by the SEC. In addition, the assets of the private fund must be segregated from the portfolio of the asset management company and a custodian approved by the SEC to safeguard the assets of the private fund must be appointed. The custodian must also separate the assets of the private fund from the custodian's own proprietary portfolio.

A provident fund is a form of pooled fund to which an employer and its employees contribute as an incentive for additional savings for retirement or resignation. Regulations on provident funds are generally in line with those governing mutual and private funds, including asset segregation, asset custody, prevention of conflicts of interest, investment restrictions, asset valuation, information disclosure, investors' choice and unitization of members' rights. Provident funds are managed by a private fund manager who is approved by the SEC and appointed by the asset management company.

The only type of pension fund recognized under the laws of Thailand is the Government Pension Fund established under the Government Pension Fund Act B.E. 2539 (1996) for the purposes of ensuring benefits upon retirement, promoting awareness of saving and providing other welfare to members who are employed by government agencies.

Funds must be managed by an asset management company and such companies are generally required by law to be set up as either a private limited or public limited company and must be licensed by the SEC.

Generally, fund managers must be qualified individuals approved by the SEC.

**Others**

Other types of investment vehicles recognized under Thai law include:

- trusts for transactions in capital market, established under the Trust for Transactions in Capital Market Act, B.E. 2550 (2007) for the purposes of investing and managing investment eg institutional investors and high net worth trust funds, real estate investment trusts, exchange-traded funds and special purpose trusts (such trusts must be managed by a trustee licensed by the SEC);
- venture capital funds, which are required to be set up as a limited company or a public limited company established specifically to operate a venture capital business (such funds must be managed by a securities company licensed for venture capital management by
the SEC); and

- crowdfunding platforms, established in order for small and medium enterprises to fundraise through funding portals approved by the SEC (investors can be retail investors (with an offer limit) or non-retail investors (without an offer limit)).

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

In the context of banks, a branch of foreign commercial bank is considered as Commercial bank under the Financial Institution Act B.E. 2551 (2008). Therefore, if such branch is duly granted with approval from the BOT, it will be allowed to operate banking business in Thailand, including lending and investment activities.

In case of non-banks side, an establishment in Thailand (ie as a private limited company or public limited company) is able to conduct the lending or investment business in Thailand. If the entity in question is a foreign majority owned company, a foreign business license/certificate is needed to be granted by the MOC. Besides, if any lending and/or investment activities is by its natures regulated by the BOT (ie personal loan and nano finance) or the Fiscal Policy Office (FPO) under the MOF (ie pico finance) then approval from the BOT and/or FPO (as applicable) must be obtained.

For the purpose of the above:

- ‘Commercial bank’ means a public limited company approved to operate commercial bank business, a retail bank, a commercial bank which is a subsidiary of foreign commercial bank and a branch of foreign commercial bank being approved to operate commercial bank business in Thailand.

- ‘Credit foncier company’ means a public limited company being approved to operate credit foncier business

- ‘Finance company’ means a public limited company approved to operate finance business.

- ‘Financial institution’ means a commercial bank, a finance company and a credit foncier company.

- ‘Personal loan’ means (i) lending, purchasing, discounting or rediscounting bills or any negotiable instruments to natural person, either with or without purpose to obtain goods or services; and (ii) lending with purpose of doing business. Currently, the personal loan regulated by BOT are the unsecured personal loan, ie without collateral, which shall include (i) and the financing on hire purchase or leasing of goods, except cars and motorcycles, that are not sold by the personal loan operator in ordinary course of business, except vehicles and (ii) the financing secured by vehicle plates. Nevertheless, the regulated personal loan shall exclude loans provided for (i) education, (ii) traveling in respect of overseas employment, (iii) medical treatment, (iv) staff welfare where the employer has signed contract with the personal loan operator and (v) others as prescribed by BOT.

- ‘Nano finance’ means lending, purchasing, discounting or rediscounting bills or any negotiable instruments, hire-purchase, leasing to natural person with the purpose of doing business without assets or property as collateral. Currently, the regulated nano finance is defined as nano finance with the purpose to do business with the lending procedure flexible in line with the criteria of debtors’ group, eg start-up business. The credit limit for each debtor must not exceed THB 100,000 with the credit period as agreed between debtor and nano finance operator. Nevertheless, regulated nano finance shall exclude (i) hire-purchase and sale and lease back of car and motorcycles, (ii) car for cash and motorcycles for cash, (iii) hire-purchase and lease of goods that are sold by the nano finance operators in their ordinary course of business, (iv) traveling loan in respect of overseas employment and (v) others as further prescribed by BOT.

- Pico Finance which is regulated means lending made to a natural person either with or without assets or property as collateral, at the province on which a head office of the pico finance operator is located, and calculated the maximum interest, profits from lending, fine, fees and other expenses not exceeding the interest rate permissible under CCC. The regulated pico finance shall exclude (i) traveling loan in respect of overseas employment, (ii) loan granted as staff welfare where the employer has signed contract with the pico operator and (iii) others as prescribed by FPO.
FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

The BOT is the authority that supervises and regulates financial business and activities in Thailand. Currently, Peer-to-peer lending and consumer lending eg personal loan, nano finance and pico finance have been regulated in Thailand. The BOT is responsible for supervising the peer-to-peer lending activity whereby it requires the prospective peer-to-peer operator to participate in the BOT's Regulatory Sandbox and be licensed before operating the peer-to-peer business.

Please see Electronic payments platforms and regulation of peer-to-peer lenders.

Blockchain, smart contracts and cryptocurrencies

The BOT has implemented the FinTech regulatory sandbox (BOT Sandbox) which will enable financial institutions, as well as FinTech companies, to experiment with and develop innovative financial products or services within a well-defined space and duration, under the BOT's supervision.

The main criteria is that the products or services in questions must be the products or services which are under supervision of BOT. Otherwise, it could not participate in the BOT Sandbox. Currently, the financial services to be tested in the BOT Sandbox must be (i) relevant to infrastructure or centralised standard or (ii) required by laws to participate in the BOT Sandbox.

According to the practice guidance concerning the FinTech regulatory sandbox issued by the BOT on 15 March 2019, the financial products or services which can enter into the Sandbox must have the following criteria:

- being financial products / services regulated by the BOT;
- being financial products / services or FinTech innovation using new technology – it could be (i) a new innovation, (ii) different from currently available financial products or services in Thailand or (iii) an innovation which applies new technology to improve efficiency of existing products/services; and
- having any of the following qualifications;
  - being financial products / services which could be developed to be infrastructure or centralised standard for Thai financial sectors which shall be tested together by financial service providers; or
  - being required to participate in the Sandbox by virtue of laws or relevant supervising criteria (e.g. the regulated peer-to-peer lending).

However, if the services are not qualified under the criteria above, it could be apply to be tested under the Own Sandbox scheme. The Own Sandbox is a separate and independent sandbox of each business operator but still under the monitor of BOT. Quarter report on progress of the Own Sandbox is required to be submitted to BOT.

Several FinTech companies have participated and are currently participating in the BOT Sandbox. According to the publication of BOT, technologies tested under the BOT Sandbox are for example Standardized QR Code, Biometrics (ie facial and iris recognition), Blockchain, Machine Learning and Standardized API, etc.

Initial coin offerings and token-based products

By virtue of the Emergency Decree on Digital Asset Business B.E. 2561 (2018), since 14 May 2018, the Initial Coin Offerings (ICOs) as well as the operation of Digital Assets Business in Thailand have become the regulated activity under the supervision of the SEC. Cryptocurrencies and Digital Tokens are considered as Digital Assets thereunder.

INITIAL COIN OFFERINGS (ICOS)
The ICOs under the supervision of the SEC refer to the offering of regulated Digital Tokens in Thailand. Basically, an ICO issuer must be a private or public limited company licensed by the SEC and must offer the ICO through the ICO portals licensed by the SEC. Currently, while three ICO portals are licensed by the SEC, no ICO issuer has been licensed by the SEC.

Further, the SEC has prescribed the following types of qualified investors being able to subscribe for the ICO:

- Institutional Investors or Ultra High Net Worth (UHNW) Investors;
- Venture Capital or Private Equity; and
- Other investors who are subject to the capped of offering value as prescribed by the SEC.

Similarly to the securities offerings, a disclosure-based regulation theme is applicable to the ICO whereby a prospectus is required to be submitted to the SEC and effective before the ICO can be made. Nonetheless, certain types of offerings are exempted from being supervised by the SEC (e.g. an offering of Digital Tokens by the Bank of Thailand) or from the disclosure and prospectus requirements (e.g. a private placement of Digital Tokens to limited types of investors).

OPERATION OF DIGITAL ASSETS BUSINESS

The Emergency Decree on Digital Asset Business B.E. 2561 (2018) categorised three types of business operation which are relevant to the digital assets; being (i) Digital Asset Exchange, (ii) Digital Asset Broker and (iii) Digital Asset Dealer. These three businesses are subject to licensing requirements of the SEC prior to operating its digital assets-related business in Thailand.

To prevent the illegal use of digital assets, the SEC requires the secondary trading or exchange of the digital tokens to be done only through the licensed Digital Asset operators. Besides, in case where the ICO issuer and / or the Digital Asset operators receives cryptocurrencies as remuneration or part of transaction, only the cryptocurrencies tradeable or exchangeable at the licensed Digital Asset operators can be accepted.

Artificial intelligence and robo advisory systems

Currently, there are no particular laws that are specifically intended to apply to the artificial intelligence (AI) and robo advisory systems; and there is no regulatory sandbox exclusively dedicated to AI and robo advisory systems.

However, the SEC has supported the use of technology especially AI and robo advisory systems in the context of securities. The SEC therefore has cooperated with private sectors to opening an official website under the project named 'Five Steps to Investment with Confidence' which is so-called 'Wealth Advice for All'. This project is aimed to be an introductory platform for investors to easily connect with wealth advisors as licensed by the SEC with less associated investment costs and to advocate long-term financial well-being of Thai nationals.

Certain licensed operators are implementing AI and robo advisory systems when providing investment consultation services. To be qualified as a licensed wealth advisor, the operator must be licensed by the SEC to provide securities/derivatives business and shall also be equipped with reliable systems and personnel in response to the five key concerns of the SEC i.e.:

- exploring and understanding customers;
- constructing an investment portfolio;
- implementing the portfolio according to the asset allocation plan;
- monitoring and rebalancing the portfolio; and
- providing consolidated reports for clients' review.

Please see FinTech products and uses – particular rules.

Data analysis and cloud computing

Currently, there are no particular laws that are specifically intended to apply to the data analysis and cloud computing market; and there is no regulatory sandbox exclusively dedicated to data analysis and cloud computing activities.

There is no specific legal requirement for the use of cloud services. However, a service provider of electronic transactions under the
Electronic Transaction Act B.E. 2544 (2001) who opts in to use the cloud services are encouraged to follow the Notification of the Electronic Transaction Committee re: Guideline on Application of Cloud Services B.E. 2562 (2019) (Cloud Guideline) which sets out the fundamental criteria and recommendations when using the cloud services regardless of whether the cloud services are provided by third parties. Initially, the Cloud Guideline guides on key considerations in several aspects which should be factored when using the cloud services, eg policies and practices of electronic transactions service providers, efficiency of cloud services, security, data management and personal data protection.

Please see FinTech products and uses – particular rules.

*Last modified 4 Apr 2020*

**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

Due to the wide range of FinTech products in the market, the regulatory authorities with responsibility will depend on the type of FinTech products involved. Currently, there are four main supervisory authorities under which FinTech activities or products may be caught:

- the Bank of Thailand (BOT);
- the Securities and Exchange Commission of Thailand (SEC);
- the Stock Exchange of Thailand (SET); and
- the Office of Insurance Commission (OIC); and
- the Board of Investment of Thailand (BOI).

**GENERAL**

A person cannot carry on a restricted / regulated activity in Thailand unless authorization or exemption is granted (known as the general prohibition). Most financial activity requires regulatory authorization when:

- it is identified as a specified activity in relation to a specified investment;
- it is carried on by way of business in Thailand; and
- it does not fall within any of the available exemptions.

Where FinTech products or applications involve financial activities which require regulatory authorization, the firms providing such products or applications must be authorized by the relevant supervisory authority.

**FINTECH REGULATORY SANDBOX**

Please see FinTech products and uses – common technology products for the FinTech Regulatory Sandbox offered by the Bank of Thailand.

The SEC set up the FinTech Department and Data Management and Analytics Department (effective from 1 January 2017) to work on a strategic plan concerning innovation in capital markets.

**REGULATORY DEVELOPMENTS ON INVESTMENT PLATFORMS**

A draft FinTech Act is currently under review by the relevant authorities and stakeholders. On 4 September 2017, the public hearing of the draft FinTech Act emphasized its importance and revised it to reflect comments raised by parties who may be affected by its enactment.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**ELECTRONIC PAYMENT PLATFORMS**

The Payment System Act B.E. 2560 (2017) (PSA) has been enacted to regulate electronic payment businesses in Thailand. The PSA has
categorised three types of payment-related businesses under the supervision of the BOT as follows:

- **Highly Important Payment Systems**: These are payment systems that are a principal infrastructure of the country whose problems or disruptions would be likely to affect members systemically, and handle large value fund transfers or used for clearing or settlement between members; including the payment systems operated by the BOT which are the inter-bank large value funds transfer systems (BAHTNET) and Imaged Cheque Clearing and Archive System (ICAS). In addition, the Minister of Finance is empowered to designate other payment systems to be the highly important payment systems.

- **Designated Payment Systems**: These are payment systems that (i) are the center or network between system users for handling funds transfer, clearing or settlement eg retail funds transfer systems, payment card network, settlement system, etc, and or (ii) may affect public interests, public confidence or stability and security of the payment systems.

- **Designated Payment Services**: The regulated payment services are (i) credit card, debit card, or ATM card services, (ii) electronic money services, (iii) acceptance of electronic payment for and on behalf of others, (iv) electronic money transfer services, and (v) other payment services which may affect payment systems or public interests.

In order to legally operate an electronic payment business in Thailand, prospective operators (either natural or juristic persons) need to comply with applicable requirements before operating permitted electronic payment activities. The applicable requirements depend on the types of electronic payment activities to be conducted but would be either to register or to obtain a license from the BOT. Further details regarding regulation of electronic payment platforms can be found on the BOT website.

**PEER-TO-PEER LENDERS**

Due to the enactment of the MOF Notification re Business Subject to Approval to Clause 5 of the Revolutionary Council Decree 58 (Regulated Peer-to-Peer Lending Platform Business) and the BOT Notification No. SorNorSor. 4/2562 re Regulations, Procedures and Conditions for Conducting Peer-to-Peer Lending Business through Electronic System/Platform (BOT Notification re Peer-to-Peer Lending), the peer-to-peer lending is a regulated activity in Thailand.

The BOT has been authorised to be an in-charge authority for:

- receiving an application form;
- specifying applicable regulations; and
- requiring a business operator to apply for an application to the BOT’s Regulatory Sandbox.

According to the BOT Notification re Peer-to-Peer Lending, the BOT requires an operator who wishes to conduct the peer-to-peer lending business through electronic system/platform to:

- make an individual consultation to the BOT;
- participate in the BOT’s Regulatory Sandbox until reaching successful outcome; and
- apply for the application of the peer-to-peer lending business through electronic system/platform prior to legally operate the peer-to-peer lending business through electronic system/platform in Thailand.

Please note the operator must be a company incorporated in Thailand with the registered and paid-up capital of at least THB5 million (including shareholder’s equity) and have a Thai shareholder holding not less than 75% of total shares with the right to vote.

Scope of business activity of peer-to-peer lending business through electronic system/platform is being an online market place or matchmaker whereby a loan agreement between a lender and a natural person borrower will be made through electronic system/platform and the loan must be granted in THB currency.

The maximum of the total amount of loan granted by each lender through any peer-to-peer ending operators is not exceeding THB500,000 per lender within any 12-month period unless such lender that is a qualified institutional investor, a private equity, a venture capital or a specific investor. The interest chargeable is not exceeding 15% per annum.

Apart from the above, the general principle for monetary lending under the Civil and Commercial Code of Thailand (CCC) is that borrowing of money in amounts above THB2,000 must be evidenced in writing and signed by the borrower. If such formalities are not complied with, a claim cannot be made against the other party to the transaction. According to the Electronic Transaction Act B.E. 2544, such evidence
can be in an electronic form, since electronic data and signatures are enforceable if such electronic data is accessible and usable for subsequent reference without its meaning being altered and if the electronic signatures are made using a reliable method to identify the signatories.

**Regulation of payment services**

Please see [Electronic payments platforms and regulation of peer-to-peer lenders](#) above.

**Application of data protection and consumer laws**

**DATA PROTECTION LAW**

The Personal Data Protection Act B.E. 2562 (2019) (PDPA) has recently been enacted on 28 May 2019. Due to the one-year grace period, the PDPA will fully be enforceable on 28 May 2020. The PDPA signals a new dawn in the handling of personal data in Thailand because prior to the PDPA, Thailand did not have an overarching law governing the protection of personally identifiable information. The collection, use and disclosure of personal data in Thailand were regulated to an extent by a patchwork of laws including the Constitution, sector-specific legislation and various self-regulatory codes. The PDPA is mainly similar to the EU General Data Protection Regulation regime, bringing personal data protection law in Thailand in line with other jurisdictions.

The PDPA introduces two key roles in collecting, processing and transfer of personal data. The Personal Data Administrator (Data Administrator) will have overall responsibility to determine and control the use of personal data. The Personal Data Processor (Data Processor) will be responsible for using, disclosing or processing the data on behalf of, or in accordance with, the instructions of a Data Administrator.

Affirmative consent must be obtained from the data subject in order for Data Administrators to legitimately collect personal data. Data Administrators must obtain consent for any use or disclosure of data that is beyond the original collection request. There are however limited circumstances in which Data Administrators may be exempt from obtaining the data subject's consent.

The PDPA applies to all organisations that collect, use or disclose personal data in Thailand. This is regardless of whether they are formed or recognised under Thai law; and whether they have residence, office or place of business in Thailand. Cross-border transfer of personal data outside of Thailand is prohibited, unless the recipient country's data protection standard is equivalent or higher than the PDPA but limited exceptions are available.

**CONSUMER LAW**

The Consumer Protection Act B.E. 2522 (CPA) has been enforced with an aim to provide protection for consumers who buy or obtain services or are offered goods or services. The CPA applies to business operators who are:

- sellers, manufacturers or importers of goods or are purchasers of such goods for re-sale; and
- service providers, including those who operate an advertising business.

The CPA provides protection for consumers in several aspects eg advertisement, unsafe goods, labelling and contractual requirements etc. To ensure the consumer protection, the Consumer Case Procedure Act B.E. 2551 (2008) has been enacted to provide specific procedural requirements in relation to a consumer litigation.

**Money laundering regulations**

In addition to commercial banks and other governmental authorities, certain other business operators are subject to anti-money laundering laws in Thailand. According to the Anti-Money Laundering Act B.E. 2542 (1999) (AMLA) and subordinated regulations, certain business operators are subject to the requirements under AMLA to:

- report required transactions (e.g. cash transactions with amounts exceeding specified thresholds);
- procure know-your-customer (KYC) checks; and
- arrange customer due diligence.

Apart from financial institutions (eg commercial banks, finance companies, credit foncier companies, securities companies, insurance companies and operators of regulated payment systems or services, etc.), certain non-financial institution business operators covered by
the AMLA include:

- non-financial institutions providing advice or acting as advisors in transactions relating to the investment or movement of funds under the law governing securities and the stock exchange;
- operators trading precious stones, diamonds, gems, gold, or ornaments decorated with precious stones, diamonds, gems or gold;
- operators trading in or providing the hire-purchase of cars;
- operators acting as brokers or agents in respect of the purchase or sale of immovable property;
- operators trading in antiques under laws governing the sale by auction and trading of antiques;
- operators providing personal loans under the supervision of businesses that are not financial institutions or who are not caught by the Ministry of Finance's notification requirements in respect of personal loan businesses or who do not otherwise fall under the supervision of the laws governing financial institution businesses;
- operators transacting in electronic money that are not financial institutions caught by the Ministry of Finance's notification requirements in respect of electronic money or that are not otherwise subject to the laws governing financial institution businesses;
- non-financial institution operators conducting credit card business;
- electronic payment operators governed by laws relating to the supervision of electronic payment service business; and
- non-financial institution operators carrying out currency exchange activities as specified in the relevant ministerial regulation.

The Anti-Money Laundering Office is the supervisory authority of the AMLA.

**Last modified 4 Apr 2020**

### What type of funding arrangements and incentives are available to FinTech businesses?

#### Early stage

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital (VC) providers.

**CROWDFUNDING**

Crowdfunding platforms are currently available under the supervision of the Thai Securities and Exchange Commission (SEC). The funding portal used for screening the offering company, disclosing information and educating investors must be approved by the SEC. Moreover, the approved funding portal must also categorize its members as either retail investors or non-retail investors (e.g., VC, private equity trust and qualified investors). Retail investors will be subject to a limit on investment while non-retail investors will not be subject to such a limit.

Currently, both equity and debt crowdfunding are permitted in Thailand.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

**ACCELERATORS**

There are various incubators or accelerators in the Thai market which offer support, facilities and funding for startups, often in return for an equity stake.

### Venture capital and debt

VC funding is a type of equity investment usually targeted at early-stage FinTech companies with an established business and some
trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund, examples of which include Beacon Venture Capital (being a CVC vehicle of Kasikorn Bank PLC) or Digital Ventures (being a CVC vehicle of Siam Commercial Bank). Both CVCs are targeting FinTech startups. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

VC debt is not available in the funding market as the corporate laws in Thailand do not allow conversion of debt to equity or the issuance of convertible debt instruments by a private limited company (which is the form of business vehicle commonly used by startups in Thailand). However, we have been working with the relevant authorities to amend the relevant laws and regulations to facilitate the funding market for startups in Thailand, including amendments to allow debt-to-equity conversion and the issuance of convertible debt instruments by private limited companies in Thailand.

In addition, proposed amendments to corporate law to promote and facilitate the funding market for startups include changes to:

- allow the offer of shares in a private limited company to employees / directors under an Employee Stock Option Plan (ESOP) and creditors under debt-to-equity conversion programs or convertible debt instruments;
- enable the rights attached to preference shares to be amended by special resolution of shareholders; and
- enable a private limited company to buy back its shares, subject to certain requirements and criteria being met.

Warehouse and platform funding

The SEC is currently actively monitoring the SEC FinTech regulatory sandbox relating to investment advisors, private funds, clearing and settlement activities and electronic trading platforms (ETP).

In addition to the FinTech regulatory sandbox, there is also a know-your-customer (KYC) regulatory sandbox which enables temporary rules to apply to business activities which do not need to be supervised by the FinTech regulatory sandbox. Temporary rules for Limited Brokerage Dealing and Underwriting (LBDU) are now also available.

To participate in the SEC FinTech regulatory sandbox, FinTech companies must fulfil the requirements set out in relevant SEC regulations. Generally, to enter into the FinTech regulatory sandbox, businesses need to:

- involve innovation in financial services;
- be operationally ready in terms of capital, work systems, human resources, risk management processes and customer contact processes; and
- have an exit strategy.

Please see FinTech products and uses – particular rules.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Thailand has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) can be done in the SET and MAI, depending on applicable criteria and requirements. However, IPOs are not a popular funding arrangement for FinTech companies because FinTech is an emerging sector with numerous applicable regulations and with incentives which are less favorable when compared to other jurisdictions in the region such as the Singapore market.
Incentives and reliefs

Thai Revenue Department (RD) has continuously provided tax incentives and reliefs to qualified startups and SMEs including its investors, e.g. VC and angel investors. The conditions and qualifications of eligible person/entities under the tax schemes granted are amended periodically.

In respect of startup itself, the key conditions and qualifications to be eligible for 5-year corporate income tax exemption are, e.g. being incorporated during the prescribed period, having at least THB5 million of registered capital, having the income not exceeding THB30 million in the accounting year whereby 80% of which is generated from the operating targeted business, and applying for an approval with the RD.

Further to the foregoing, the startup must operate the targeted business as specified by the National Science and Technology Development Agency, including businesses in the following industries:

- food and agriculture;
- energy saving, renewable energy and clean energy;
- biotechnology;
- medical and public health;
- tourism, services and creative economic;
- advanced materials;
- textiles, fabrics and accessories;
- vehicles and auto parts;
- electronics, computers, software and information services; and
- research and innovation.

VC and angel investors are also subject to certain requirements in order to claim for tax privileges e.g. participating in an investment during the promoted period, and retaining the investment within the minimum period, etc.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party’s rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

- **Assignment** – An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. However, the assignee is able to claim such assignment against the debtor only if such transfer is notified to the debtor in writing; and if the debtor consents in writing to such transfer, the debtor will not be able to use any defense it has over the assignor against the assignee.
Under Thai law, the security will not automatically transfer with the loan which it secures. An amendment to the security agreement or a new security agreement (as the case may be) must be done to secure the transferred loan.

Please note that there is no specific provision on sub-participation under Thai law. However, commercial banks will be subject to requirements and criteria under the risk participation regulations of the Bank of Thailand.

**What are the main considerations when transferring a loan and related security?**

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

An asset management company approved by the Bank of Thailand for the purpose of transferring assets (ie non-performing assets) from financial institutions will benefit from, for example, exemptions on (i) certain fees and taxes and (ii) requirements to provide notices of transfer.

**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Thailand varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

**Energy**

**GAS**

PTT Public Company Limited (PTT) is a state-owned listed oil and gas company. It owns gas pipelines and LPG terminals and engages in the production of oil and gas as well as petrochemical products. PTT has many subsidiaries investing in various sectors. Private
participation is allowed in the gas sector through receipt of concessions from the government. There are encumbrances on investment in certain areas e.g. LPG in terms of strict criteria and conditions for investment. Therefore, few private investors engage in such business sector.

There are six main companies engaging in oil refinery business in Thailand:

- Thai Oil Public Limited Company;
- PTT Global Chemical Public Company Limited;
- Star Petroleum Refining Public Company Limited;
- Bangchak Petroleum Public Company Limited;
- IRPC Public Company Limited; and
- Esso (Thailand) Public Company Limited.

ELECTRICITY

Three state enterprises manage the electricity industry in Thailand. The Electricity Generating Authority of Thailand (EGAT) is responsible for producing, generating and transmitting electricity. The Metropolitan Electricity Authority (MEA) and the Provincial Electricity Authority (PEA) deal with distribution of electricity. Private sector entities are able to participate in the electricity business as electricity producer in accordance with government policy.

There are three main types of private electricity producer:

- Independent Power Producer (IPP);
- Small Power Producer (SPP); and
- Very Small Power Producer (VSPP).

Telecoms infrastructure

The National Broadcasting and Telecommunication Commission (NBTC) is an independent state organization empowering to assign the frequencies and to regulate the broadcasting and telecommunications businesses with regard to the utmost public benefit. Private entities are able to take part in telecommunication business through an auction and licensing process. Qualified candidates need to accept terms and conditions specified by NBTC before entering into an auction to engage in telecoms infrastructure. The major telecommunications operators are True Move, DTAC and AIS.

TOT Public Limited Company (TOT) and CAT Telecom Public Limited Company (CAT) operate national telecommunications and provide international telecommunication services. Both are Thai state-owned telecommunications companies.

Transport infrastructure

URBAN TRANSPORT

Currently, there are three urban rail transport systems operating in Thailand and connecting Bangkok with outer Bangkok and urban areas; being the Bangkok Mass Transit System (BTS), Metropolitan Rapid Transit (MRT) and Airport Rail Link (ARL).

- Bangkok Mass Transit System Public Limited Company (BTSC) built and operated the BTS which was entirely funded by private sectors. The BTSC's 30-year concession awarded by the Bangkok Metropolitan Authority (BMA) ends in 2029, following which (subject to renewal), the BTS business will be transferred to the BMA because the concession is in the form of a Build Operate Transfer (BOT) contract.

- The MRT is a cooperation between public and private sectors. The Mass Rapid Transit Authority of Thailand (MRTA) as a project owner built the infrastructure and offered the operating concession to the Bangkok Expressway and Metro Public Limited Company (BEM).

- The ARL is entirely owned by State Railway of Thailand (SRT) and operated by State Railway of Thailand Electrified Train Company Limited which is now a state enterprise under the supervision of the Ministry of Transportation.

- Additional rail and urban transport systems are currently under working progress whereby the main project owner is MRTA.
NATIONAL RAIL

Double-track rail and high speed railway projects are currently under construction or negotiation process. SRT is responsible for study and procurement of both projects. High speed railway projects which have been active are:

- Bangkok – Nakhon Ratchasima;
- Nakhon Ratchasima – Nong Khai;
- High-speed rail linking three airports;
- U-Tapao – Rayong;
- Bangkok – Chiang Mai; and
- Bangkok – Padang Besar.

Certain routes of high speed railway project have the cooperation from foreign countries eg Italy, China and Japan in terms of technology transfer. Private sector is able to participate in the investment on both projects in the form of public-private partnerships scheme (PPP) which is usually made by auction process.

ROADS, BRIDGES AND TUNNELS

Roads

The Department of Highways (DOH), an authority under the supervision of Ministry of Transportation, is responsible for research and development, construction, expansion, maintenance and renovation of the motorways, national highways and concession highways. Rural and local highways are under the responsibility of the Department of Rural Highways (DORH) and local authorities, respectively. The Expressway Authority of Thailand is responsible for expressway whereby BEM receives the concession to be an operator. Don Muang Tollway Public Limited Company won an auction to manage and collect toll revenues of the Don Muang Tollway which is the highway under the supervision of DOH. Private sector participates in the roads investment by procurement process of sub-contracts, eg a construction contract, a system installation contract or a design, operation and maintenance contract.

Bridges and tunnels

The sub-divisions of the DOH and DORH called the Bureaus of Bridge Construction are responsible for construction of bridges and tunnels over and around a highway under its responsibility. Unless local competent authorities are responsible for design, construction and maintenance of bridges and tunnels in the area of its responsibility eg Department of Public Work of Bangkok is responsible for construction of bridges and tunnels in certain areas of Bangkok.

Aviation

Airport of Thailand Public Limited Company (a majority state owned company) owns and operates main airports in Thailand. Private ownership on airports, and aircrafts is recognized in Thailand as long as relevant licenses are obtained. All models are heavily regulated by government and the Civil Aviation Authority of Thailand which is the aviation regulator in Thailand.

Port

Port Authority of Thailand (PAT) is the supervisory authority of ports in Thailand. Six main ports are under the regulation of PAT which assigns the management. Private can invest in port business eg sea port business by licensing process.

Other infrastructure

EASTERN ECONOMIC CORRIDOR (EEC)

The EEC is a developing economic zone created with an aim:

- to increase and improve infrastructure such as rails, deep seaports, and aircraft;
- to create business, industrial clusters, and innovation hubs; and
Investment privileges and benefits which available to qualified investors of the EEC regime relate to tax in terms of corporate income tax and import duties, land ownership permission, and visa and work permits for non-Thai nationals. Plus, financial assistance for purposes of innovative R&D or experts development of the targeted business could also be obtained.

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS / PRISONS)

Private participation is permitted in social infrastructure area in order to assist public sector providing such infrastructure not to directly earn profits.

**Education**

A licensed person or entity is able to establish a school or university. Specific requirements may be applied depending on each type of entities established eg allocation of profits to reserved funds of school, maintenance of Thai majority committees of university and requirement of notification to supervisory authorities on an incident-based basis.

**Hospitals**

A license is mandatory in order to operate sanatorium. Regulatory compliance is also of important for this type of business operation.

**DEFENSE**

Typically, defense assets are owned by the public sector.

**WASTE**

The Pollution Control Department (PCD) is the main supervisory authority of waste management in Thailand. PCD then hires private sector to procure waste collection and waste management.

**WATER**

The authority in charge of water industry in Thailand is Metropolitan Waterworks Authority and Provincial Waterworks Authority. East Water Resources Development and Management Public Limited Company (EW) was set up for privatization of water industry. EW handles development of water resources for both industrial and consuming purpose for the eastern part of Thailand to support the plan to create main industrial district of Thailand. Other private companies also take part in investment on water infrastructure eg water-supply projects. Waste water management is under the responsibility of Public Works Department. Establishment of factory dealing with waste water treatment by private companies is allowed provided that license or approval from relevant authorities are duly obtained.

*Last modified 4 Apr 2020*

**Are there special rules for investing in energy and infrastructure?**

**Generally**

Generally, investment in the infrastructure business takes the form of public-private partnerships (PPP). The main law is therefore the Public-Private Partnership Act B.E. 2562 (2019) (PPP Act). Where public government authorities procure private sectors, the Government Procurement and Supplies Management Act B.E. 2560 (2017) (GPSMA) is also relevant.

PPP Act generally sets out:

- the PPP Committee to regulate and supervise the private investment on State undertaking;
- eligible categories of infrastructure projects and public services to be invested under the PPP Act:
  - roads, highways, special ways and land-transportation;
- trains, electric trains and other rail-transportation;
- airports and air-transportation;
- ports and water-transportation;
- water management, irrigation, waterworks and wastewater;
- energy works;
- telecommunications and general communications;
- hospitals and public health;
- schools and education;
- housing and facilities for low or medium wage earners, the elderly, underprivileged or disabled;
- exhibition centres and conference centres; and
- other projects as to be announced by Royal Decree.

 dönme:the investment threshold and applicable rules and procedures being; a project with a value from THB5 billion is subject to the rules and procedures under the PPP Act while others with a value less than THB5 billion is subject to rules and procedures of the PPP Committee; and

dönme:criteria and process of the joint investment between the authority which is a project owner and private sector e.g. feasibility study of the project, selection of private party and on-going supervision of the project, etc.

GPSMA sets out methods and process of procurement, consideration, criteria for selection of offer and forms of contract of procurement.

Foreign Direct Investment (FDI) in infrastructure sectors is not strictly prohibited under Thai law. However, a foreign business license (FBL) or foreign business certificate (FBC) pursuant to the Foreign Business Act B.E. 2542 (1999) (FBA) will normally be required if an operating company is considered a foreigner (being a foreign established entity or a Thai established entity with at least 50% of its shares are owned by foreign natural person and/or foreign entities) unless a foreigner invests in construction of infrastructure for public services in the sphere of public utilities or transportation which requires special apparatuses, machines, technology or expertise with the minimum capital of THB500 million or upwards, FBL or FBC is not required.

Under the Investment Promotion Act B.E. 2520 (1977) (IPA), if the operating business is within the scope of promoted business activities, such company may be eligible for tax and/or non-tax privileges eg right to own a land because it is normally prohibited for a foreigner to have land ownership under Thai laws.

Compliance with Factory Act B.E. 2535 (1992) and Town Planning Act B.E. 2518 (1975) and its subordinated laws is also of importance as the violation of having the license to operate a factory or procedures to take before construction of building could result in revocation of premises as well as civil and criminal sanctions.

Other special requirements could be specified in the term of reference of the project in question or contracts between private investors and public authorities.

Please note that there are ministerial regulations and other subordinated laws, e.g. notification or order, issued pursuant to the act.

**Energy**

The specific laws and/or regulations regarding the investment in energy sector include:

- Energy Industry Act B.E. 2550 (2007) empowers the Energy Regulatory Commission as the supervisory authority for operation of energy industry business and sets out provisions regarding process for application of a license to operate the industry business and details of energy business operation e.g. standards and safety.
- Petroleum Act B.E. 2514 (1971) empowers the Petroleum Commission as the supervisory authority for energy business operation and sets out details of concession to operate the petroleum business and the operation of the petroleum business e.g. sale and disposal and payment of governmental fees.
- Fuel Trade Act B.E. 2543 (2000) sets out regulatory provisions regarding the trading, transportation and quality of fuel as well as
preventive and mitigation measures for fuel shortage.

- Fuel Control Act B.E. 2542 (1999) empowers the Fuel Control Commission as the supervisory authority for business operation concerning with possession of fuel, fuel station, fuel storage and transportation of fuel as well as sets out details and requirement of such business operators.


**Telecoms infrastructure**

The specific laws and/or regulations regarding the investment in telecoms infrastructure include:

- Radio Communications Act, B.E. 2498 (1955) sets out provisions regarding licensing application and approval for production, use, importation, exportation and trading of radio communication equipment.

- Sound Broadcasting and Television Broadcasting Act B.E. 2498 (1955) sets out provisions regarding licensing application and approval for sound and television broadcasting business including legal obligation from such business operation.

- Telecommunications Business Act B.E. 2544. (2001) sets out provisions regarding licensing application and approval for operation of telecommunication business, requirements to access and interconnect telecommunication network, standard of telecommunication network and equipment, rights of licensee and user and details of contract between the licensee and user.

- Broadcasting and Television Businesses Act B.E. 2551 (2008) sets out provisions regarding licensing application and approval for operation of broadcasting and television business, details of types of business, ratio and details of programs to be broadcasted and requirements for construction of fundamental network and the use and connect of network.

- Organization to assign Radio Frequency and to regulate the Broadcasting and Telecommunications Services B.E. 2553 (2010) empowers NBTC and the National Telecommunications Commission (NTC) as the supervisory authority for business operation of broadcasting, television and telecommunication and sets out provisions regarding licensing application for such business operation.

**Transport infrastructure**

As mentioned above, mostly the form of investment in rail and road is PPP. Therefore, the relevant laws are for example PPP Act, GPSMA, FBA and IPA.

**Other infrastructure**

**SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS / PRISONS)**

The main acts regulating the below social infrastructure are as follows.

**Education**

- Private School Act B.E. 2550 (2007) empowers the Office of the Private Education Commission as the supervisory authority for operation of private school and sets out provisions regarding the requirements for establishment of private school in terms of licensing, operation and funds.

- Private Higher Education Institution Act B.E. 2546 (2003) empowers the Office of the Higher Education Commission as the supervisory authority for operation of private higher education institution and sets out provisions regarding the requirements for establishment of private higher education institution in terms of licensing, operation and funds.

**Hospitals**

Sanatorium Act, B.E. 2541 (1998) empowers the Sanatorium Commission as the supervisory authority for operation of sanatoriums and sets out provisions regarding the requirements for establishment of sanatorium in terms of licensing and operation.

*Last modified 4 Apr 2020*

**What is the applicable procurement process?**
The Government Procurement and Supplies Management Act B.E. 2560 (2017) (GPSMA) is the recently enacted act regulating procurement process of public sector which is not captured under the PPP Act. Under the GPSMA, there are four methods for procurement:

- **General invitation** – Public authorities generally invite an operator and any qualified operator is able to make the offer. The relevant committee of each project will consider offers based on consideration of various factors, e.g. offering price, cost, quality of product or service and after-sale service, etc. The selection process could be different depending on practice of each authority. However, the principle of transparency is generally applied.

- **Selection process** – Public authorities invite at least three operators possessing qualifications specified by such authorities to make an offer.

- **Specific method** – Similar to the selection method but only one qualified operator is chosen to make an offer or negotiate with the authorities.

- **Design contest** – This approach is used only for the procurement of design or supervision of construction where it concerns with special construction to compliment fine arts or architecture of Thailand.

Public procurement is relevant where the Thai government or public authorities is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset.

Requirements and conditions to participate in the procurement process are different depending on the terms of reference (TOR) of each project. In rail infrastructure procurement, some additional requirements or conditions are added to match the nature or type of such project.

In most cases, the public authorities will need to publish a contract notice and/or TOR in its website and typically run one of the four procurement procedures under the GPSMA. Date, time and place to submit the offer or other electronics means are generally included in such publication. If the bidding process is needed, details will also stipulate in such publication.

The procurement process under the GPSMA is not applicable to certain projects including but not limited to:

- procurement of state enterprise in relation to direct commerce;
- procurement of arms and services regarding national security by G2G method or from other foreign countries whereby its laws specified otherwise;
- procurement for research and development to provide educational services to higher education or hire of consultancy which cannot follow the procurement under GPSMA;
- procurement by using loan or financial assistance from foreign entities; or
- procurement of higher education or sanatorium which is a public division.

A procurement which is not governed by procurement process under GPSMA will be subject to criteria specified by the Policy Committee of Government Procurement and Supplies Management.

**Investing in energy and infrastructure**

According to PPP Act, the public authority which is the project owner needs to conduct the feasibility study and prepare the joint investment project plan. A qualified external consultant is required to be hired to assist in studying the project and preparing the joint investment project plan. After the completion of the feasibility study and joint investment project plan, the project owner needs to request the approvals from the relevant minister and the PPP Committee in relation to the principle of the joint investment project plan. Once those approvals are duly granted, the matter will then be forwarded to the cabinet for final approval.

In relation to the selection process of private party, a bidding is a default method under the PPP Act. However, in certain limited cases, the cabinet may approve other means for the selection process. Under the bidding process, the project owner shall prepare a draft invitation to tender, draft document for selection of private entity and draft joint investment contract and propose them for the PPP Committee's approval. Once approved, the selection process of private party shall begin.

Upon receiving the result of the selection process and the draft joint investment contract negotiated with the selected private party, such draft joint investment contract shall be submitted to the Office of Attorney-General for review. Consequently, the full set of (i) selection
result, (ii) reviewed draft joint investment contract and (iii) material conditions of the project shall be reviewed and approved by the minister of the project owner and the cabinet before executing the joint investment contract with the selected party.

After the joint investment contract is executed, the PPP Supervisory Committee will be set up to supervise the investment project. Revision to the executed joint investment contract could be done if the PPP Supervisory Committee's approval is granted and the draft of revised joint investment contract is approved by the Office of Attorney-General and the minister of the project owner.

Financing energy and infrastructure

The public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Thailand are:

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate-finance basis (balance sheet debt);
- loans made on a project-finance basis;
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing.

Investing

Common forms of investing in energy and infrastructure include:

- Infrastructure fund which must be listed on the SET to raise capital from both individual investors and institutional investors in order to finance infrastructure projects across Thailand. Infrastructure fund is allowed to invest in infrastructure projects, for example, railway, road / expressway / toll-way / concession way, alternative energy, natural disaster prevention system, waterworks, airport / airfield, telecommunications system and irrigation system / water management system.telecommunications system and irrigation system / water management system.
- Infrastructure trust which must be listed to raise funds from the public. The trust can invest in infrastructure assets of greenfield and / or brownfield projects. Infrastructure trust is allowed to invest in infrastructure projects that provide benefits to the public either in Thailand or overseas, for example, railroad, electrical power generating system, waterworks, road or expressway or concession way, airport, deep sea port, telecommunications system, alternative energy, irrigation system, natural disaster prevention system, pipeline transportation system and multi-infrastructure project with joint benefits to the community or interconnected communities.

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?
When the Securities and Exchange Commission, the Stock Exchange of Thailand, the Bank of Thailand or the Ministry of Finance considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation run by its committee and to the extent permissible under the laws concerning duties of those authorities. This may result in regulatory sanctions.

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**What regulatory penalties may apply?**

Regulatory penalties generally include:

- revocation / cancellation of licenses or permission;
- prevention from trading or involving in the securities market eg prohibition to be a director or executive of listed companies; and
- reimbursement of benefits received from regulatory violation or of expenses arising from investigation.

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**What criminal penalties may apply?**

Fines including daily fines until a violation is corrected and/or imprisonment are generally imposed to a natural person or company violating the regulations.

A director of the company may be subject to a fine or imprisonment if he or she orders or omits an action resulting in the company’s violation. However, fines and other regulatory penalties are generally imposed provided that it is the company that violates the law.

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**Tax**

**Tax issues**

*Are stamp, registration, transfer or other similar taxes applicable?*

**Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?**

**ADVANCE OF LOAN**

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan. However, the loan agreement itself is required to be affixed with stamp duty of THB1 for every THB2,000 or its fraction (i.e. 0.05% of the loan principal amount). The maximum stamp duty payable on a loan agreement is THB10,000.

**TRANSFER OR ASSIGNMENT OF A LOAN**

No stamp, registration, transfer or other similar taxes are payable on an assignment agreement for the transfer or assignment of a debt under a loan. Note that if a new loan agreement is to be executed, stamp duty will need to be affixed at the rate as mentioned above.

**Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

**MORTGAGES**

Mortgages must be registered with the relevant government authority. Government fees for mortgage registrations are variable.
depending on the type of mortgaged property. Government fees are normally calculated on a percentage basis subject to variable maximum caps. No stamp duty is required to be paid.

Mortgages can be transferred or assigned to secure the transferred or assigned debts to which they relate. The registration fees are normally calculated on a percentage basis with variable maximum caps. No stamp duty is required to be paid.

DEBENTURES

The transfer of a corporate debenture is required to be affixed with THB1 stamp duty for every THB1,000 or its fraction (i.e. 0.1%) of the face value of the instrument.

OTHER SECURITY

A guarantee is required to be affixed with stamp duty of between THB1 to THB10.

A pledge is required to be affixed with stamp duty of THB1 per every THB2,000 or fraction thereof (i.e. 0.05%) of the amount of debt which it secures. Stamp duty is not required to be paid if the loan agreement which is secured by such pledge is duly affixed with stamp duty.

A business security agreement under the Business Security Act B.E. 2558 (2015) is required to be registered with the relevant authority and is subject to the payment of certain government fees. No stamp duty is required to be paid.

**Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?**

A corporate bond is required to be affixed with stamp duty of THB5.

Any government bond sold in Thailand is required to be affixed with stamp duty of THB1 for every THB100 or its fraction (i.e. 1%) of the face value of the instrument.

The transfer of a Thai government bond and of certain instruments issued by Bank for Agriculture and Agricultural Cooperatives are exempt from stamp duty.

Bills (i.e. bills of exchange and promissory notes) are required to be affixed with stamp duty of THB3 per instrument, except for a series of such bills or notes if the first bill or note is duly affixed with stamp duty.

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**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over the Revenue Department on enforcement of a security.

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**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Yes, Thailand levies a withholding tax on interest payments under a loan. Profits earned from the sale of a bond or the redemption of bills are also subject to withholding tax.

**If so:**

**What is the rate of withholding?**

The current rate of withholding tax on loan interest in Thailand (i.e. the basic rate) is 1% where the lender is a legal entity residing in Thailand and 15% where the lender is a natural person residing in Thailand.
The current rate of withholding tax (i.e. the basic rate) applicable to a legal entity or a natural person residing outside Thailand is 15%.

**What are the key exemptions?**

Exemptions from withholding tax on interest include those applicable to:

- payments of interest under a loan made by either a commercial bank, a finance company, a security company, a credit finance company or an asset management company regulated under Thai law (each a Finance Entity) or a legal entity of a Finance Entity and certain foundations or associations; and

- payments of interest to a payee resident in a country which has a double tax treaty with Thailand (such treaty may only provide for a partial exemption).

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

The applicable exemptions from withholding tax on interest payments under a debt security depend on the type of payer, for example:

- payments of interest, including, but not limited to, interest arising from bonds, deposits, debentures and bills issued, made or entered into by a Finance Entity or certain foundations or associations to another Finance Entity or certain foundations or associations, is exempt from withholding tax;

- payments of interest arising from bonds and debentures issued or entered into by a legal entity (which is not a Finance Entity) to any Finance Entity is subject to a reduced withholding tax rate of 1%; and

- payments of interest arising from bills issued by a legal entity (which is not a Finance Entity) to any legal entity (which is not a Finance Entity) is subject to a reduced withholding tax rate of 1%.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

No.

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

Yes.

**Key contacts**

**Timothy Tan**  
Partner  
DLA Piper (Thailand) Limited  
timothy.tan@dlapiper.com  
T: +662 686 8550
Ukraine

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

It is unlawful to offer debt securities to the public in Ukraine, or to request that they are admitted to trading on a stock exchange operating in Ukraine, unless an approved prospectus has been made available to the public. A prospectus should include information on the issuer, its financial and economic position and the securities being issued.

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What are common issuing methods and types of debt securities?

The following debt securities are commonly used in Ukraine:

- corporate bonds;
- sovereign bonds of Ukraine (issued by the state);
- municipal bonds (securities issued by local authorities);
- treasury bills of Ukraine;
- certificates of deposit (securities to be issued by the National Bank of Ukraine with redemption right on a redemption date);
- promissory notes; and
- bonds of international financial organizations (such as the European Bank for Reconstruction and Development).

In practice, the issuance of local securities is usually documented as a standalone offering. Program offerings are in place but are uncommon.

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What are the differences between offering debt securities to institutional/professional or other investors?

Ukrainian law does not yet have sophisticated regulation in respect of institutional/professional investors. There is, however, the draft law ‘On Amending Certain Legislative Acts of Ukraine in relation to Investment Attraction and Introducing of New Financial Instrument’ approved by the Ukrainian Parliament in the first reading relating to investor (client) categorization. In particular, investors will be distinguished between qualified and non-qualified investors in line with Markets in Financial Instruments Directive II 2014/65/EU (MiFID II).
The nature of the investor, their experience in the financial market and awareness about market products are relevant to the determination of the category. As a result, the different protection regimes will apply to investors. Non-qualified investors will be protected with the highest degree of regulatory protection, while qualified investors will have less protection.

_Last modified 24 Jan 2020_

**When is it necessary to prepare a prospectus?**

An offer would not be deemed to have been made to the public if it is addressed to fewer than 100 persons.

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**What are the main exchanges available?**

There are four principal markets on which debt securities are traded:

- the Ukrainian Exchange;
- the Ukrainian Stock Exchange;
- the PFTS Ukraine Stock Exchange; and
- the Ukraine Interbank Currency Exchange.

_Last modified 24 Jan 2020_

**Is there a private placement market?**

Ukraine has a non-active private placement market. Generally, shareholders use private placement as a means of funding companies' needs.

_Last modified 24 Jan 2020_

**Are there any other notable risks or issues around issuing or investing in debt securities?**

**Issuing debt securities**

Issuers are responsible for prospectuses for debt securities. Offering documentation shall not contain any misrepresentation, omission or misstatement which may give rise to civil, administrative and criminal liability under Ukrainian legislation. The Criminal Code of Ukraine prescribes criminal liability for deliberate misrepresentation (fraud) in the documents submitted for registration.

**Investing in debt securities**

Once issued and placed, debt security terms cannot be modified.

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**Establishing and investing in debt / hedge funds**

**Are there any restrictions on establishing a fund?**

The Law of Ukraine ‘On Collective Investment Funds’ dated 5 July 2012 determines the different procedures for establishing corporate and unit funds.

**Corporate funds**
A corporate investment fund is incorporated as a legal entity. It may be created only by way of establishment (no merger, division or transformation is permitted as a method of creating a fund). Members of governing bodies of such funds, for example the supervisory board and board of directors, have to comply with certain requirements.

A fund shall be established in accordance with the process set out by law. A failure to comply with the pre-determined stages may give grounds for the Security Commission to refuse to grant a registration certificate for a corporate fund's shares or to register a fund's rules.

**Unit funds**

A unit investment fund does not have legal entity status under Ukrainian law. Such funds are established and operated by asset management companies.

Asset management companies are commonly incorporated in the form of limited liability companies or joint-stock companies and are entitled to render asset management services to institutional investors only after having obtained a license from the National Securities and Stock Market Commission. Members of governing bodies of asset management companies have to comply with certain requirements.

**What are common fund structures?**

Common forms of funds under Ukrainian law include:

- open-ended funds (redemption is possible at any time);
- interval funds (redemption is possible at periods set out in the prospectus); and
- closed-end types (redemption is only possible upon termination).

Depending on the duration of operation, a fund may be either fixed-term or perpetual.

Collective investment funds may also take the following forms:

- diversified funds (funds created to meet diversification criteria based on asset types);
- specialized funds (money market funds, government securities funds, bond funds, equity funds, index funds or bank metal funds);
- qualified funds (funds dealing with particular classes of assets, for example, pools of loans, real estate or securities funds); and
- non-diversified funds (any other funds which do not fall in the above categories).

**What are the differences between offering fund securities to professional / institutional or other investors?**

Ukrainian law makes a distinction between retail and institutional investors, but despite this statutory distinction, there is no sophisticated legislation which sets out different legal regimes for the marketing and selling of debt securities to professional or retail investors.

The Ukrainian draft law 'On Amending Certain Legislative Acts of Ukraine in relation to Investment Attraction and Introducing of New Financial Instrument' which has been pre-approved by Parliament, contains the Markets in Financial Instruments Directive II 2014/65/EU (MiFID II) approach to client categorization. In particular, investors will be distinguished between qualified and non-qualified investors depending on the nature of the investor, their experience in the financial market and awareness about market products, among other factors. In general, qualified investors require less regulatory protection, while non-qualified investors are protected with the highest degree of regulatory protection.

**Are there any other notable risks or issues around establishing and investing in funds?**
Establishing funds

Investment funds are generally held in separate accounts subject to the discretionary authority of the fund manager who shall acquire and dispose of assets using the funds in accordance with a pre-determined strategy set out in a management agreement entered into between the fund and the fund manager.

Managing investments is a regulated activity under Ukrainian law, therefore asset management companies are subject to authorization from the National Securities and Stock Market Commission.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

There are no selling restrictions applicable to offering securities under Ukrainian law.

Are there any restrictions on managing a fund?

Fund management is a regulated activity carried on by an asset management company on the basis of a management agreement. An asset management company has to obtain a license from the National Securities and Stock Market Commission.

Various restrictions apply to fund managers and their operations in the course of managing funds:

- independent custodian (a non-related party to the fund's participants);
- independent valuator of assets (a non-related party to the fund's participants); and
- independent auditor (a non-related party to the fund's participants).

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

A person entering into a derivative contract as a dealer in Ukraine will commonly be authorized under Ukrainian law, although the licensing procedure is not clear as the legislation on this is fragmented.

There is not yet sophisticated legislation governing the regulatory, insolvency and other aspects of derivative transactions. However, note that comprehensive amendments introducing European Market Infrastructure Regulation (EMIR), Markets in Financial Instruments Directive II (MiFID II) and Markets in Financial Instruments Regulation (MiFIR) standards into local statutory law are now being considered by the Ukrainian Parliament and are expected to be adopted soon.

What are common types of derivatives?

Derivatives may be traded over-the-counter or on an organized exchange.

The most common types of underlying assets seen in Ukraine are commodities and foreign currencies.

As other types of assets, including equity, credit events and fixed income instruments, are less developed in Ukraine, Ukrainian
counterparties tend to document these transactions via offshore entities and subject to foreign law.

*Last modified 24 Jan 2020*

**Are there any other notable risks or issues around entering into derivatives contracts?**

Ukrainian law lacks a number of derivative-related concepts, including: close-out netting, novation of trades, margin requirements (in relation to title security) and effective disclosure rules. There is not sufficient legal regulation in respect of title security or escrow arrangements, reporting requirements, trade repository and central counterparty. However, the aforementioned concepts have been addressed in the draft law 'On Amending Certain Legislative Acts of Ukraine in relation to Investment Attraction and Introducing of New Financial Instrument' already approved by the Ukrainian Parliament in the first reading.

*Last modified 24 Jan 2020*

**Debt finance**

**Lending and borrowing**

**Are there any restrictions on lending and borrowing?**

**Lending**

Generally, lending is a regulated activity only in relation to consumer lending. Lending made available to borrowers by financial institutions at the expense of attracted funds are also regulated. The lender (being a bank or financial institution) must be authorized by the National Bank of Ukraine or Financial Authority. Corporates and individuals may rely on statutory exemption.

**Borrowing**

Borrowing is generally not a regulated activity but note that consumer borrowers are afforded more beneficial legal protection than other borrowers.

*Last modified 24 Jan 2020*

**What are common lending structures?**

Lending may be structured in a number of different ways depending on various factors.

**Number of parties**

- Bilateral loans (one lender to one or several borrowers)
- Syndicated loans (multiple lenders)

Note that syndicated structures are rarely seen between local banks and borrowers, however, it is quite common for Ukrainian borrowers to structure their borrowings as syndicated deals with foreign lenders outside Ukraine.

**Loan security**

- Secured loans
- Unsecured loans

**Types of facility**

- Term loan facility
Revolving term facility
Overdraft facility
Bridging loan

Repayment profiles
Amortizing payment
Balloon payment
Bullet payment

What are the differences between lending to institutional / professional or other borrowers?

Ukrainian law does not contain sophisticated regulation in relation to lending to institutional/professional borrowers. Generally, the regulation is less onerous on lenders to institutional/professional borrowers.

Do the laws recognize the principles of agency and trusts?

For a long time, Ukraine as a civil law jurisdiction did not recognize trust structures. The Law of Ukraine ‘On Amendments to Certain Legislative Acts in relation to Stimulation of Investment Activity in Ukraine’ dated 20 September 2019 introduced the concept of security trust in Ukrainian law. The fulfilment of debtor’s obligations may be secured by way of transferring to the creditor, acting as a trustee, of the property owned by a debtor or a third party. A trustee receives an ownership right to the secured property, however, cannot alienate it, except for the enforcement purposes.

A trust shall be documented by a trust agreement in writing. A trust over immovable property must be notarised and becomes legally binding upon its state registration with the State Register of Proprietary Rights to Immovable Property. It is important that the trust property shall not be included into the liquidation estate neither of a trustee, nor a trustor. Furthermore, there is a carve-out for the trust property ringfencing it from moratorium under the insolvency law.

Are there any other notable risks or issues around lending?

Cross-border loans

After liberalization of the Ukrainian currency market, effectiveness and validity of the cross-border loans (and amendments thereto) between foreign lenders and Ukrainian borrowers is no more linked to their registration with the National Bank of Ukraine. Instead, the bank servicing the cross-border loan notifies the National Bank of Ukraine on the loan in the automatic information system. The mandatory interest cap rates were also cancelled, so the parties have more flexibility in agreeing terms of financing.

Specific types of lending

Ukrainian legislation provides special requirements for specific types of lending, for example, consumer lending.

The Law of Ukraine ‘On Consumer Lending’ dated 10 June 2017 introduced specific requirements in respect of the following.

PROMOTION AND ORIGINATION OF LOANS

• Advertisements for consumer lending must indicate all service fees and expenses.
Consumers must be informed of fees and costs of third parties, including insurance companies and valuers.

Compulsory assessment of borrower's affordability is also a requirement.

**ADMINISTRATION AND REPAYMENT OF LOANS**

- Outstanding principal amounts shall be repaid first.
- Outstanding interest and principal payments shall be repaid second.
- Default interest and penalty amounts shall be repaid third.

**Standard form documentation**

Loan Market Association (LMA) standard documentation is predominantly used for cross-border lending, but this is uncommon in local transactions.

**Bail-in**

Ukrainian legislation sets out bail-in arrangements which give a regulator special powers to make a conversion or writing down of a bank's liabilities to its related parties (and in some circumstances to non-related entities) by way of exchange of additionally issued shares in the amount of unencumbered monetary liabilities owed by the bank to its related parties. Bail-in legislation applies only to banks under local law.

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**Are there any other notable risks or issues around borrowing?**

Borrowing is generally unregulated activity under Ukrainian legislation.

_Last modified 24 Jan 2020_

**Giving and taking guarantees and security**

*Are there any restrictions on giving and taking guarantees and security?*

Some of the key areas affecting the giving of security are as follows.

**Capacity**

It is important to check the constitutional documents of a company giving security to ensure it has power to do so and there are no restrictions on the directors' powers. Ukrainian law does not recognize the ‘corporate benefit’ concept. Under corporate law, certain transactions (including the granting of security) are subject to corporate approval by a company's shareholders/participants or the board of directors at a general meeting.

**Insolvency**

Security may be at risk of being set aside under Ukrainian insolvency law if the security is granted by a company within a certain period of time prior to the onset of insolvency. This would be the case if the company giving the security received considerably less consideration, and as such, the transaction was at an undervalue. For such transactions to be set aside, certain statutory criteria needs to be met, including the requirement that security has been given within three years prior to the onset of insolvency of the affected company. Security may also be challenged on other grounds relating to insolvency.

**Financial assistance**

This applies to certain types of legal entity including banks and joint-stock companies. For example, banks are not allowed to extend loans to third parties for the purposes of acquiring the bank's shares or any third party bank's shares (this includes subordinated loans to
banks). Joint-stock companies are also not allowed to lend funds (including the granting of security) for the purposes of acquiring their shares or securities.

What are common types of guarantees and security?

Common forms of guarantees

Ukrainian law distinguishes between guarantee (garantiya) and suretyship (poruka).

A guarantee is a security which can only be granted by a regulated entity (a bank or other financial institution), whereby the guarantor is under a primary obligation to the creditor to pay upon a debtor's default. A guaranteeing obligation is independent to the validity and existence of the principal obligation.

A suretyship can be provided by corporates or individuals. Under suretyship a surety undertakes to perform the principal obligation secured by suretyship, for and instead of the defaulting debtor. Under Ukrainian law a suretyship is a secondary obligation, meaning that its validity and existence is entirely dependent on the validity and existence of the principal obligation.

Common forms of security

There are three basic types of security interest that can be created under Ukrainian law:

- a pledge;
- a suretyship; and
- a mortgage.

Different types of security are suitable for securing different types of assets.

Under Ukrainian law it is possible to grant security over all of the assets of an Ukrainian company or individual assets. Granting security over all of a company's assets will tend to be achieved by way of mortgage over a business unit (an integral property complex) which will include:

- a mortgage over real estate; and
- a mortgage over fixed assets and equipment (except for movable equipment).

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing and signed by the guarantor.

Giving or taking security

A security document may need to be executed as a notarial deed if it contains:

- a mortgage over land;
- a mortgage over immovable property; or
- a mortgage over space facilities.

Parties may elect to have any security contract notarized. Generally, notarization gives the lender:
additional comfort in terms of the counterparty's capacity to enter the contract; and
additional enforcement benefits (a notary writ may be an out-of-court remedy available to the lender).

Certain types of assets cannot be pledged or mortgaged. For example, assets which have a cultural heritage cannot be pledged. Agricultural land can only be mortgaged to banks.

**Perfection and registration requirements**

- Encumbrance of immovable property with a mortgage is subject to a mandatory registration with the State Register of Proprietary Rights to Immovable Property.
- Encumbrance entries recording ranking and priority against third parties' claims over pledged movable assets, and prohibiting the disposal of pledged (movable) assets, shall be registered at State Register of Pledges over Movable Properties.
- An absence of state registration affects the validity of a mortgage.

Failure to comply with perfection and registration requirements means that the ranking or enforceability of the movable pledge can be undermined and the creditor's claims will rank alongside unsecured creditors.

Security is at risk of being set aside in certain circumstances under insolvency laws. For more information, see Giving and taking guarantees and security – restrictions.

**Financial regulation**

**Law and regulation**

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

- Civil Code of Ukraine (No.435-IV, 16.01.2003) (general contractual principles)
- Commercial Code of Ukraine (No.436-IV, 16.01.2003) (general principles governing business to business transactions)

**Consumer credit**

- Law of Ukraine ‘On Consumer Lending' dated 10 June 2017 (No.1734-VIII, 10.06.2017) (consumer lending)

**Mortgages**

- Law of Ukraine ‘On Pledge' dated 2 October 1992 (No.2654-XII, 02.10.1992) (general provisions on pledges, including mortgage transactions)
Law of Ukraine ‘On Mortgage’ dated 5 June 2003 (No.898-IV, 05.06.2003) (mortgages and mortgage notes)


Business entities (banks, financial institutions)


Funds and platforms

Law of Ukraine ‘On Collective Investment Funds’ dated 5 July 2012 (No.5080-VI, 05.07.2012) (establishment, operation and termination of collective investment funds)

Other key market legislation


Decision No. 1688 ‘On Approval of Regulation on Functioning of Stock Markets’ approved by the National Securities and Stock Market Commission dated 22 November 2012 (No.1688, 22.11.2012) ttp://zakon3.rada.gov.ua/laws/show/z2082-12 (principles and requirements for trading on the stock exchanges)


Law of Ukraine ‘On Payment Systems and Money Transfer in Ukraine’ dated 5 April 2001 (No.2346-III, 05.04.2001) (payment systems regulation)


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Regulatory authorization

Who are the regulators?

There are three independent state authorities which supervise financial markets and financial products:

- The National Bank of Ukraine (NBU) oversees banks and the bank lending market.
- The National Securities and Stock Market Commission (Securities Commission) is responsible for supervision of securities, regulated markets and derivatives.
The National Commission for Regulation of Financial Services Markets of Ukraine (Financial Market Commission) is the regulator for non-banking financial lending, for example, peer-to-peer lending and Lombard lending.

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What are the authorization requirements and process?

Depending on the type of financial institution, a firm shall apply for authorization from either the National Bank of Ukraine, the National Securities and Stock Market Commission or the National Commission for Regulation of Financial Services Markets of Ukraine. The relevant regulator will assess the application on the terms set out in statutory law.

Banking activity

The application fee for a banking license amounts to GBP1,134 (UAH 35,890) and the procedure takes two months following receipt of the full set of application documents.

Financial services

The application fee for a license for carrying on financial services, including factoring, financial leasing and asset management, amounts to GBP64 (UAH 2,027) and the procedure takes thirty days following receipt of the full set of application documents.

The application fee for a license for carrying on particular types of professional activities in the capital market amounts to GBP95 (UAH 3,000) and the procedure takes three months following receipt of the full set of application documents for Ukraine residents, and six months for non-Ukraine residents.

Staff requirements

There may be certain requirements for key individuals, including senior management, to be employed in banks, funds and financial institutions. The regulator will assess whether or not they meet the applicable requirements.

Registers

Authorized firms, banks and individuals are listed in the following registers:

- State Register of Financial Institutions;
- State Register of Financial Institutions that Provide Financial Services in the Securities Market;
- Register of Payment Systems;
- List of Operating Banks; and
- Unified State Register of Collective Investment Funds (publicly unavailable but information may be provided on charged basis).

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What are the main ongoing compliance requirements?

Compliance requirements may be applicable to banks, funds and financial institutions. Ukrainian law sets out general compliance and prudential requirements depending on the type of financial activity, such as lending, asset management, securities trading or fund investment.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for a bank, fund or financial institution and regulated individuals, as well as loss of regulated status.

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What are the penalties for failure to be authorized?
Banking activity

Carrying on banking activity, banking transactions or other financial services without the appropriate license or in violation of such license may be subject to fines ranging from GBP54 (UAH1,700) to GBP1,610 (UAH51,000) depending on the size of profit received from unauthorized transactions, among other factors.

Financial services

Carrying on financial services without the appropriate license or in violation of such license may be subject to fines ranging from GBP537 (UAH17,000) to GBP2,685 (UAH85,000) depending on the size of profit received from unauthorized transactions, among other factors.

The National Securities and Stock Market Commission may impose penalties on participants in financial markets for an unauthorized activity (without a license) in amounts ranging from GBP537 (UAH17,000) to GBP5,369 (UAH170,000).

Regulated activities

**What finance and investment activities require authorization?**

Generally, financial services shall be provided by an authorized entity included in the local registry of financial institutions. Some specific types of services require additional licenses.

The below services are deemed to be financial services:

- banking and associated transactions;
- capital market transactions;
- issuance and/or servicing and clearing of payment documents, payment cards, travellers' cheques and other forms of payment provision;
- transactions relating to mortgage assets for the purpose of issuing mortgage-back securities;
- fiduciary management of financial assets;
- money transfer and remittance;
- lending (including financial facilities);
- currency exchange activity;
- financial leasing;
- provision of guarantees and suretyship;
- insurance services and fully funded pension provision;
- factoring;
- asset management for construction finance or real estate finance; and
- others.

Are there any possible exemptions?

Generally, financial services may only be provided by funds, banks and financial institutions, unless an exemption applies.
Corporates and individuals are exempt and are able to give loans and suretyships for their commercial needs.

**Do any exchange controls or other restrictions on payments apply?**

**General restrictions**

The new Law of Ukraine ‘On Currency and Currency Operations’ and secondary legislation of the National Bank of Ukraine effective as of 7 February 2019 liberalised Ukrainian currency control regulation and set out new core principles for currency transactions. The new regulation introduced significant changes and simplifications in the currency market which give more freedom to both business and individuals.

Permanent currency control and exchange restrictions include:

- settlements within the territory of Ukraine shall be made in Hryvna (UAH);
- financial monitoring for transactions in access of UAH 150,000 equivalent; and
- import or export of foreign currency (in excess of EUR10,000) shall be declared in custom declarations.

**Temporary restrictions**

NBU Regulation No. 5 ‘On Approval of the Regulation on Protective Measures and Determination of the Procedure for Caring out of Particular Foreign Currency Transactions’ dated 2 January 2019 introduced protective measures which will remain effective for an indefinite period until cancelled by the National Bank of Ukraine. Key protective measures include:

- E-limits for individuals (EUR100,000 equivalent per year) and corporates (EUR2,000,000 equivalent per year) on the outgoing payments in foreign currency abroad;
- 365-day limitation period for conducting settlement under export and/or import contracts.

**Cashless payment restrictions**

The National Bank of Ukraine limits cash payments in same day transactions:

- between legal entities – to GBP305 (UAH10,000); and
- between individuals/individuals and legal entities – to GBP1,527 (UAH50,000).

All payments on amounts exceeding the above thresholds shall not be paid in cash and shall be made by way of bank transfer.

**Anti-money laundering restrictions**

If any payment in a financial transaction appears to be suspicious or relates to money laundering or terrorism financing, such settlements may be stopped or suspended by a bank, financial institution or state authority. The screening period will range from two to 30 days (unless extended). The payments will be blocked during that period.

**What are the rules around financial promotions?**

**Rules**

Financial institutions are not allowed to disseminate misleading advertising about financial services and products, for example, deposits, consumer credits, investments and mortgages.

In marketing or offering financial services, a financial institution must inform a client about certain matters, including:

- details of proposed financial services and their actual cost;
• terms and costs of additional financial services;
• payment of applicable taxes and duties; and
• consequences of acceleration or early termination under the agreement.

It is prohibited under Ukrainian law to advertise securities offerings, including specifying the amount of returns under debt securities, predicting the increase in value of debt securities (except for fixed rate securities), advertising prior to the registration of the issuance of debt securities, and promoting information about returns without stating that this does not guarantee an expected return.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Banks

In Ukraine, banks are commonly formed as public joint-stock companies.

Funds

Investment funds (corporate funds) are incorporated as joint-stock companies.

Unit investment funds do not have legal entity status under Ukrainian law, however, their operating fund managers shall be established in the form of asset management companies that are either limited liability or joint-stock companies.

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

Banks

Ukrainian law allows foreign banks to establish branches in Ukraine, however, such branches are only entitled to carry on lending and banking services upon special accreditation being given by the National Bank of Ukraine. Such branches act on behalf of foreign banks and are not deemed to be legal entities.

Funds

Unlike banks and insurance companies, foreign investment funds cannot operate in Ukraine via a branch or other permanent establishment. Ukrainian law requires that funds are incorporated in Ukraine and licensed by the National Securities and Stock Market Commission.

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FinTech

FinTech products and uses
What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- consumer loans; and
- small and medium-sized enterprises lending;

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P)-type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition, to or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

Ukrainian law does not regulate securitization. If the funding of the marketplace lending is structured through a revolving loan and includes tranching of the debt, this will not result in the platform being treated as a securitization for the purposes of regulation. Thus, it would neither be required to have risk retention nor provide appropriate reporting and disclosures.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever
transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Although there were several bills registered in the Ukrainian Parliament aimed at creating the regulatory framework for virtual assets and currencies, Ukrainian law still lacks regulation on cryptocurrency. At the same time, use of cryptocurrency is not prohibited or restricted by the state, so Ukraine can be considered a jurisdiction with a neutral approach.

In November 2019 the Ministry of Digital Transformation of Ukraine and Binance, a global cryptocurrency exchange, signed Memorandum of Understanding. The parties agreed to cooperate in the determining of legal status of cryptocurrency and virtual assets in Ukraine and creating of the legal framework that would meet the requirements of the industry.
The Ministry of Digital Transformation also signed Memorandum of Cooperation with Belarusian company Currency.com on developing Ukrainian legislation in the field of IT and crypto regulation using the Belarusian experience.

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.
Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The National Commission for Regulation of Financial Services Market (NCRFSM) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets. In order to operate, the firms have to be incorporated as a non-banking financial institution under Ukrainian law.

GENERAL

A person must not carry on a regulated activity in Ukraine unless authorized or exempt. A financial activity requires regulatory authorization when it:

- is identified as a specified activity in relation to a specified investment;
- is carried on by way of business in Ukraine; and
- does not fall within any of the available exemptions.

Where FinTech products and applications involve financial activity which requires regulatory authorization, the firms providing such products and applications must be authorized by the NCRFSM.

INNOVATION

In the past few years, Ukraine has been actively demonstrated its focus on promoting a blockchain system.

On 13 April 2017, the state agency for e-governance of Ukraine partnered with Bitfury Group, a US-based global technology company, to launch what is probably the largest project on transferring government data on a blockchain platform. This technology initiative was launched to increase the transparency of government data and efficiency of its use by both local and global customers.

The project has three blockchain initiatives:

- **State Register of Proprietary Rights to Immovable Property** – This involves putting data on all ownership, lease titles and other *in-rem* rights including encumbrances records on blockchain platforms to improve data protection, transparency and security.

- **State Land Cadastre** – This is a pilot blockchain-based project aimed at improving data storage on legal titles to land in Ukraine. This technology will phase in a web-based auction platform whereby local and international customers will be able to lease Ukrainian state-owned land plots.

- **SETAM** – This provides businesses with access to the public auction platform built on blockchain technology, enabling users to buy assets of the Ukrainian distressed and insolvent entities.

In 2018 the Blockchain Association of Ukraine was established. It is a non-profit organisation which unites blockchain and crypto industry specialists and promotes the integration of blockchain technology into the economy of Ukraine. The Association launched BlockchainHub Academy, a free course for preparation of specialists for the blockchain industry, and practical course for developers. Members of the Association are also working on elaboration of the necessary regulatory basis for the industry and lobby its implementation in Ukraine.

Furthermore, there is an inter-factional association called “blockchain4Ukraine” in the Ukrainian Parliament which is working on blockchain related draft laws.

REGULATORY DEVELOPMENTS ON INVESTMENT PLATFORMS

In September 2017, the payment systems regulator (NBU) published an initiative to support FinTech development in Ukraine, recognizing the increasingly important role of investment platforms in the retail distribution landscape. This initiative will focus on the impact of investment platforms providing digital lending (both peer-to-peer (P2P) and business-to-peer (B2P)) as well as non-banking lending to small and medium-sized enterprises.
In January 2020, the Strategy of Ukrainian Financial Sector Development until 2025 approved by the National Bank of Ukraine and all other financial market regulators was presented. The Strategy is aimed at reforming and development of Ukraine's financial sector in line with international best practices and the EU-Ukraine Association Agreement. Among the major priorities are introducing innovations in the financial sector and development of financial markets.

**Electronic payments platforms and regulation of peer-to-peer lenders**

**Electronic payment platforms**

The NBU is the payment systems regulator and it currently regulates 78 payment systems, including MasterCard, Visa, American Express and PivatMoney. All participants in a designated payment system will fall under the remit of the payment systems regulator, including operators that manage or operate the systems, the payment service providers using the system and the infrastructure providers to the payment system.

The NBU Regulation No. 481 'On Amendments to Certain Legislative Acts of the National Bank of Ukraine in respect of the E-Money Issuance and Circulation' dated 4 November 2010, contains a number of electronic money-related rules, directions and guidance aimed at businesses that are issuing or considering the issuing of electronic money (e-money). E-money is defined as electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person other than the electronic money issuer and include pre-paid cards and electronic pre-paid accounts for use online. Generally, an issuer of e-money must be registered as a bank under Ukrainian law and must have a banking license granted by the NBU.

**Peer-to-peer lenders**

A person carries out a regulated activity (requiring authorization by the NCRFSM) if they facilitate lending and borrowing between two individuals or between individuals and businesses. According to NBU P2P activity is not a banking activity under Ukrainian banking law, and that P2P lenders are to be notified in advance by marketplaces that they are not eligible for any deposit protection scheme. In light of this, all P2P marketplaces require authorization from the NCRFSM and are subject to supervision of the NCRFSM as non-banking financial institutions.

**Regulation of payment services**

Where a Ukrainian business provides payment services as a regular occupation or business activity in Ukraine, it will require authorization by the NBU to become an authorized payment institution under Ukrainian law 'On Financial Services and State Regulation of Financial Services Markets'. Under Ukrainian law, an authorized payment institution may be incorporated only in a form of either a bank or a financial institution. Failure to obtain the required authorization is an administrative offence.

In order to become authorized by the NBU, a payment services business will need to meet certain criteria, including in relation to its business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

**Application of data protection and consumer laws**

The Personal Data Protection Law (PDPL) regulates the processing of personal data in Ukraine. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the PDPL and have certain notification and compliance obligations. The PDPA implements the European Data Protection Directive 95/46/EC.

The Ukrainian law 'On Electronic Commerce' 2015, regulates unsolicited direct marketing by electronic means, in addition to sector specific regulations, for instance, financial promotion rules established by the Ukrainian law 'On Advertising' 1996.

Finally, the Ukrainian law 'On Consumer Lending' 2015, sets out certain provisions and procedures to protect consumers. A lender must follow and comply with these statutory requirements while making available loans to consumers.

**Money laundering regulations**

The Ukrainian law 'On Prevention and Counteraction to Legalization (Laundering) of the Proceeds from Crime or Terrorism Financing, and Financing Proliferation of Weapons of Mass Destruction' 2014 gives the NCRFSM responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as non-banking lending, providing payment services and issuing and administering...
other means of payment.

Generally, the NSRFSM authorizes and supervises a company for complying with anti-money laundering requirements. Electronic currencies such as bitcoin and other cryptocurrencies tend to represent a higher money-laundering risk. It is worth noting that in those cases where Ukrainian banks issue e-money, the NBU may also supervise them for compliance with anti-money laundering requirements.

**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

**ACCELERATORS**

There are various incubators or accelerators in the Ukrainian market which offer support, facilities and funding for startups, often in return for an equity stake. For example, Kyivstar, a major mobile operator, has an accelerator program which offers investment, and mentoring from industry experts. There are also Borsch Ventures, Polyteco, GrothUP, Founder Institute, Happy Farm and EastLab.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the
originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks. In 2016, UAH 5 billion was originated through P2P platforms in Ukraine. P2P lending does not involve equity investments, and instead interest is paid on the money borrowed.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. Bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

The capital market in Ukraine is in a state of development. So far, funding in both debt and equity capital markets is uncommon and typically inaccessible to businesses.

**Incentives and reliefs**

Ukrainian legislation does not provide for any special tax incentives for FinTech companies and activities related to FinTech. However, there are certain tax incentives which may be potentially applicable to FinTech companies.

For example, small and medium-sized enterprises can benefit from 0% of income tax rate if they meet certain criteria.

Also, a supply of program products (including software) within the territory of Ukraine is temporarily exempted from VAT until 1 January 2023. This incentive may be applicable to the supply of special FinTech software.

*Last modified 24 Jan 2020*

**Portfolio sales**

**Loan transfers and portfolio sales**

**What are common ways of buying and selling loans?**

The Civil Code of Ukraine sets out the grounds for selling and buying loans.

The most common ways of selling loans are:

- assignment; and
- novation.

A loan transfer is commonly documented under a factoring contract. However, note that a loan purchaser shall be an authorized entity (being a factoring company and holding a license from the National Commission for Regulation of Financial Services Markets of Ukraine).

Loan Market Association (LMA) secondary market documentation is used by Ukrainian banks for transferring commitments under loans with foreign parties.

*Last modified 24 Jan 2020*

**What are the main considerations when transferring a loan and related security?**

Key considerations include:
• **confidentiality** – consent is usually required for disclosure except for by banks which are permitted under banking law to disclose information relating to loans;

• **bank secrecy restrictions** – consent for disclosure of information constituting such secrecy is required;

• **data protection** – personal data shall not be disclosed without the consent of the holder of such data;

• **contractual restrictions** – the contract may stipulate some restrictions on transferee parties (black list or white list);

• **consent and/or notification** – novation requires mutual consents (borrower, lender and any third party security provider) whereas an assignment requires a notice to be given to the borrower; and

• **assignment restrictions** – contractual prohibition on assignment to third parties contained in the underlying debt obligation can be an issue except for instances where a factoring company is the purchaser of the debt.

Note that a factoring contract is valid irrespective of the existence of a prohibition on assignment of a monetary claim and other restrictions between the primary lender and the borrower.

*Last modified 24 Jan 2020*

**Projects**

**Financing / investing in energy / infrastructure**

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in Ukraine varies according to the asset class and sector. The main asset classes are usually considered to be:

• economic infrastructure (energy, aviation, rail, telecommunications, roads and waste); and

• social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

**Energy**

The gas and electricity industries in Ukraine are partially privatized. Gas producers and gas distribution companies are privately owned, however, transmission, distribution grids and infrastructure are owned and operated by the state via public companies (Ukrtransgaz). The state is also present in other areas in the gas market such as gas production (NAK Naftogas, UkrGasVydobuvannya) while supply services are provided by a number of private sector companies. The Ukrainian gas market is heavily regulated.

Ukraine intends to reduce gradually the number of state-owned objects and launched privatization of state-owned companies. Every year the Ukrainian government approves the list of state-owned enterprises for privatization, including regional electricity supply companies.

The National Energy and Utilities Regulation Commission is responsible for the regulation of the electricity market in Ukraine.

**Telecoms infrastructure**

The telecommunications networks (mobile and fixed) in Ukraine are mostly privately owned by a number of service providers.

The National Commission for the State Regulation of Communications and Informatization is the regulator for the Ukraine telecommunications sector. The State Committee for Television and Radio Broadcasting of Ukraine also regulates the television broadcast services and wireless communication services.

**Rail infrastructure**
LIGHT RAIL

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies.

HEAVY RAIL

The rail market in Ukraine involves both public and private entities. The principal elements to the rail sector in Ukraine are as follows:

- **Ukrzaliznytsia**, a state-owned public joint-stock company, which is on the public sector balance sheet and owns, operates and maintains rail tracks, signaling and station infrastructure. It is responsible for improving most of the regulated national rail infrastructure and for operating some of the stations on the national rail network. Ukrainian energy authorities have been conducting a corporate restructuring over the assets of Ukrzaliznytsia and foreign management has been employed to operate the company and increase business efficiency.

- **Freight Operating Companies** are wholly commercial entities.

- **Project finance** – There has been a number of project finance models dealing with and on that deal it is the private sector which owns the trains and will continue to do so following the expiry of the main contract with the public sector.

The rail sector is regulated by the Ministry of Infrastructure.

Other infrastructure

ROADS, BRIDGES AND TUNNELS

A government entity, the State Agency of Automobile Roads of Ukraine, operates, maintains and improves the motorways and major roads (ie the strategic road network) in Ukraine. The State Agency of Automobile Roads of Ukraine is regulated by the Ministry of Infrastructure and receives funding from the government for investment in the strategic road network (including additional road capacity). Local roads in Ukraine are the responsibility of local authorities. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector (on a concession basis or otherwise). This year the government announced that it would be sponsoring a lot of tender procurement on the construction of the strategic road network.

AVIATION

Aviation in Ukraine is (for the most part) privatized. As regards airport infrastructure, there are a number of ownership structures in Ukraine, including public ownership, local government ownership and various forms of public-private ownership (airports in the cities of Odessa and Kyiv). All models are heavily regulated by the government and the State Aviation Administration is the aviation regulator in the Ukraine.

PORTS

The Ukrainian ports sector is mostly publicly owned, however, the government is considering different options to attract private investors (on a concession, lease or other model). Operating commercial companies, which operate in major Ukrainian ports are privately owned.

EDUCATION, HOSPITALS, DEFENSE AND WASTE

Typically, these assets are mostly owned by the public sector.

Last modified 24 Jan 2020

**Are there special rules for investing in energy and infrastructure?**

**Generally**

There is no specific regime restricting investment in energy or infrastructure projects in Ukraine for investors and funders but a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules, authorizations, currency control restrictions).

In the course of the planning and implementation of an underlying energy or infrastructure project (in which the investment is to be
made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order, and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval.

The gas and energy markets in Ukraine have a complex system of arrangements between suppliers, generators, transmitters and distributors which are heavily regulated. In particular, there are complex arrangements in respect of licensing, environmental permits, dangerous work performance permits, charging mechanisms with suppliers and customers and access to the local grid system.

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What is the applicable procurement process?

Public procurement in Ukraine is in most instances governed by the Law of Ukraine ‘On Public Procurement’ dated 25 December 2015 which is based on EU Directives and EU best practice. In addition, note that the new Law ‘On Concession’ dated 3 October 2019 and the Law ‘On Public Private Partnership’ dated 1 July 2010 contain some specifics on procurement process.

Additionally, there is established Model Contract on Lease of State Owned Property.

Investing in energy and infrastructure

The Law of Ukraine ‘On Public Procurement’ dated 25 December 2015 sets out the following procedures:

- **Open bidding procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submitting a tender offer in response to a notice. The pricing element will be a decisive factor for awarding a contract and announcing the winner.

- **Competitive dialogue** – There is a shortlisting of at least three tenderers following an expression of interest stage and tenderers submit a bid. The public authority will hold negotiations on the contract terms with each of the three tenders.

- **Negotiation procedure** – This procedure allows dialogue with one or a number of bidders. It can only be used in specific circumstances prescribed by the Law of Ukraine ‘On Public Procurement’ dated 25 December 2015.

Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Investors must ensure that they are fully familiar with the funding requirements set out in the specific tender documentation.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Ukraine (including in relation to public-private partnerships) are as follows.

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term basis – such loans may be made by international financial institutions (such as the European Bank for Reconstruction and Development, the World Bank and the International Finance Corporation);
- loans made by export credit agencies; and
- asset financing (particularly relevant in the rail sector).
Investing

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment through special purpose vehicles and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of ‘equity’).

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

Where an authorized or regulated individual has breached an ongoing compliance requirement, the Regulator solely or jointly with the other respective authority is entitled to launch a formal investigation. If criminal liability is applicable, the Regulator will submit the documentation to the law enforcement bodies.

What regulatory penalties may apply?

The National Bank of Ukraine, the National Securities and Stock Market Commission or the Financial Services Market Commission may impose administrative sanctions (suspension or termination of a license, exclusion from the relevant registries of authorized entities), penalties and criminal liability on the firms and/or regulated individuals. The penalty may vary from GBPS4 (UAH 1,700) to GBPS,369 (UAH 170,000), depending on the breach.

What criminal penalties may apply?

Formal investigation may result in criminal liability being imposed on a regulated entity and personnel in certain cases, including:

- insider dealing and manipulation, misleading statements and practices;
- violations of the money laundering regulations; and
- conducting regulated activities when not authorized.

Generally, the criminal liability may be punishable by:

- penalty which may vary from £415 (UAH 13,697) to £7,787 (UAH 257,006) depending on the breach;
- imprisonment for three to 15 years; and/or
- loss of regulatory status and right to occupy positions or engage in business activities for a term of up to three years.

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?
Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable in Ukraine on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Registration of a mortgage (and the transfer or assignment of a mortgage) is subject to stamp duty at the rate of 0.01% of the value of the mortgaged property, as indicated in the mortgage agreement.

Notary fees may also apply and their amount may vary.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

**ISSUE OF DEBT SECURITIES**

The issue of debt securities is subject to stamp duty at the rate of 0.1% of the nominal value of the debt securities being issued. The maximum amount of stamp duty is capped at the level of UAH 80,000.

The issue of derivative securities is subject to stamp duty in the amount of UAH 850.

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**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

The State Fiscal Services of Ukraine does not have a priority over secured lenders or secured debt security holders, provided the security is registered in accordance with Ukrainian legislation prior to the emergence of any tax lien.

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**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Generally, Ukraine-source interest payable by Ukrainian corporate borrowers under loans provided by lenders not resident in Ukraine is subject to Ukrainian withholding tax.

Other payments (eg fees and commissions) under a loan agreement may not fall within the scope of Ukrainian withholding tax if they qualify as in return for services.

If so:

What is the rate of withholding?

The following tax rates apply to payments of interest by Ukrainian corporate borrowers under loans granted by lenders not resident in Ukraine:

- 15% – for loans provided by corporate lenders not resident in Ukraine; and
- 19.5% – for loans provided by individual lenders not resident in Ukraine.

What are the key exemptions?
A full or partial exemption from Ukrainian withholding tax on interest payable by Ukrainian corporate borrowers may be granted under double tax treaties in force in Ukraine.

Special withholding tax rules apply to interest payable by Ukrainian corporate borrowers to corporate lenders not resident in Ukraine under loan agreements, where the funds advanced were obtained by corporate lenders not resident in Ukraine from the issue of debt securities on exchanges outside of Ukraine (e.g., Eurobonds or LPNs). Under these types of structures, the rate of Ukrainian withholding tax on interest under such loan agreements with corporate lenders not resident in Ukraine is:

- completely eliminated – for loans provided before 2018; or
- reduced to 5% – for loans provided after 2019.

**Would the same analysis apply to interest payments under a debt security (e.g., a bond)?**

Yes, the same analysis applies to interest payments under a debt security.

**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g., by virtue of incorporation, residence or local branch)?

No.

**Would the same analysis apply to interest payments under a debt security (e.g., a bond)?**

Yes.
UK - England and Wales

Last modified 06 December 2019

Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both UK and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in the UK or to request that they are admitted to trading on a regulated market operating in the UK unless an approved prospectus has been made available to the public.

The International Capital Market Association has published standard form selling restrictions for offers of debt securities in the UK. These restrictions are aimed at preventing a breach of:

- the rules on financial promotion; and
- the rules on accepting deposits in the UK.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in the UK are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in the UK. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (ie debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
• warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

Last modified 6 Dec 2019

**What are the differences between offering debt securities to institutional / professional or other investors?**

On 25 June 2019, the Financial Services and Markets Act 2000 (Prospectus) Regulations 2019 (SI 2019/1043) were published. These Regulations make UK legislation compatible with the EU Prospectus Regulation (2017/1129) (Prospectus Regulation) and ensured that the Prospectus Regulation is effective and enforceable in the UK from 21 July 2019.

Under the Prospectus Regulation one of the circumstances in which a prospectus must be produced is where an offer of securities is made to the public within the European Union. An exemption from this requirement to publish a prospectus applies where offers are made solely to qualified investors (which are defined as persons or entities under the professional investor classification in the MiFID II Directive (2014/65/EU) (professional clients, persons treated as professional clients, and persons recognised as eligible counterparties)). However, if the debt securities are to be admitted to trading on an EU-regulated market a prospectus would still be required.

The nature of the information that has to be disclosed in a prospectus for the issue of debt securities under the Prospectus Regulation depends on whether the issue falls within the retail regime or the wholesale regime.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the ‘wholesale’ rules apply. If the denomination is under €100,000, the ‘retail’ rules apply. Additional disclosure requirements apply for retail securities.

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**When is it necessary to prepare a prospectus?**

Under the Prospectus Regulation (as implemented in the UK by Financial Services and Markets Act 2000 and the FCA's Prospectus Regulation Rules), securities shall only be offered to the public in the European Union after prior publication of a prospectus in accordance with the Prospectus Regulation. Securities shall only be admitted to trading on a regulated market situated or operating within the EU after prior publication of a prospectus in accordance with the Prospectus Regulation.

An offer would not be deemed to have been made to the public if, among other things, it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per member state or where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a Prospectus Regulation compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

Last modified 6 Dec 2019

**What are the main exchanges available?**

The London Stock Exchange has three principal markets on which debt securities are traded:

• the Main Market;
• the Professional Securities Market; and
• the International Securities Market.

**The London Stock Exchange Main Market**

The Main Market is a regulated market for the purposes of the Markets in Financial Instruments Directive (MiFID), so issuers on the Main Market are subject to the requirements of a number of EU Directives, including the Market Abuse Directive and the Transparency Directive. Securities listed on the Main Market can be passported to other European Economic Area markets in order to access international investors.

Last modified 6 Dec 2019
The London Stock Exchange Professional Securities Market

The Professional Securities Market is an exchange-regulated market subject to the rules of the London Stock Exchange. It is not a regulated market for the purposes of MiFID. It is therefore outside the requirements of the Prospectus regulation and provides a more flexible alternative to the requirements regarding denomination and financial information, compared to the rules which apply to regulated markets across Europe. As it permits reporting under national Generally Accepted Accounting Principles (GAAP), it offers an alternative for issuers not wishing to prepare financial information to International Financial Reporting Standards (IFRS).

The London Stock Exchange also operates the Order Book for Retail Bonds, which is an electronic trading platform for debt securities that are issued in denominations of less than £100,000 and listed on the Main Market.

The London Stock Exchange International Securities Market

The International Securities Market was launched in May 2017. It is an exchange-regulated market subject to the rules of the London Stock Exchange. Securities admitted to trading on the International Securities Market are not listed on the Official List maintained by the UK Financial Conduct Authority (FCA), so FCA approval is not required. Admission to trading and approval of the admission document is conducted by the London Stock Exchange only.

Is there a private placement market?

The UK has an active private placement market.

There is no dominant standard for documentation but efforts have been made by the Loan Market Association and International Capital Markets Association to standardize private placement documentation.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under English law. The UK has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally
Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the Financial Services and Markets Act 2000 and therefore subject to regulation by the UK Financial Conduct Authority.

**Collective Investment Schemes**

The regulations apply to activities undertaken in relation to 'Collective Investment Schemes' which are schemes comprising the following arrangements (subject to certain specific exceptions set out in the legislation):

- with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income;
- where the participants do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions; and
- that have either or both of the following characteristics:
  - pooling of investors' contributions and profits or income; and
  - the property is managed as a whole by or on behalf of the operator of the scheme.

*Last modified 6 Dec 2019*

**What are common fund structures?**

Common forms of funds, some of which are further described in the UK Financial Conduct Authority Guidance on Collective Investment Schemes, include:

- open-ended (UK Authorized Unit Trusts (AUTs), Investment Companies with Variable Capital (ICVCs) and Authorized Contractual Scheme (ACSs)) and closed-ended funds;
- retail and non-retail funds (including Alternative Investment Funds (AIFs));
- Undertakings for Collective Investments in Transferable Securities (UCITS) and non-UCITS funds; and
- qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

*Last modified 6 Dec 2019*

**What are the differences between offering fund securities to professional/institutional or other investors?**

**Retail funds**

Open-end retail funds must be either authorized by the UK Financial Conduct Authority (if UK domiciled) or recognized by the Financial Conduct Authority (if domiciled in another jurisdiction). Funds that are 'recognized' by the Financial Conduct Authority in this context mostly comprise Undertakings for Collective Investment in Transferable Securities (UCITS) funds established in other jurisdictions. Closed-end retail funds that are listed in the London Stock Exchange Main Market or specialist funds market are not 'authorized' by the Financial Conduct Authority, but the listing itself requires approval by the Financial Conduct Authority in its capacity as the UK listing authority.

Retail funds, including UCITS, are subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depositary arrangements for assets, investment and borrowing powers specifications (for open-end retail funds), concentration requirements and other matters.

**Institutional/professional funds**

In practice, non-retail funds (other than limited partnerships) are usually established outside the UK because there are no UK non-retail
tax-exempt fund vehicles (other than unauthorized unit trusts that are only offered to UK tax-exempt investors).

Closed-end funds are generally established as UK or offshore limited partnerships and open-end funds such as hedge funds are typically established as companies and unit trusts.

Non-retail funds that are offered in the UK generally fall into the category of Alternative Investment Funds (AIFs) and therefore subject to the Alternative Investment Fund Managers Directive regime in relation to authorization of the manager/fund, marketing arrangements, reporting, governance etc.

Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Separately managed accounts are also commonly used in the UK as an investment management structure – investor funds are generally held in a separate account subject to the discretionary investment authority of a manager who can acquire and dispose of assets using the investor funds in line with a pre-determined strategy and parameters set out in an Investment Management Agreement. These are often also structured as 'funds of one' in a separate vehicle.

Managing investments is a regulated activity under the UK Financial Conduct Authority rules and therefore subject to authorization; however managed accounts 'funds of one' themselves are generally not classed as (and therefore avoid the regulatory restrictions in being classed as) Collective Investment Schemes or Alternative Investment Funds.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

UK selling restrictions

Generally, in the UK, offering securities is either covered under the UK Financial Conduct Authority's financial promotion regime, under the Undertakings for Collective Investment in Transferable Securities Directive regime or under the Alternative Investment Fund Managers Directive regime.

Undertakings for Collective Investments in Transferable Securities (UCITS)

UCITS, including those established in the UK, have a EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Managers Directive, marketing is defined as: a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).
Reverse solicitation and the definition of 'marketing'

Applicable in the context of professional investors, this is a sensitive area in the UK and Europe generally. The Alternative Investment Fund Managers Directive generally continues to permit professional investors who wish to invest in AIFs based on their own initiative (reverse solicitation); however, the EU is currently reviewing this area during 2017 and may impose tighter requirements.

Specifically in the UK, the Financial Conduct Authority has provided broad guidance on the definition of 'marketing' as follows:

- Marketing will, generally, not include secondary trading in the units of an AIF. Therefore, the listing of AIF units will not necessarily constitute marketing.
- The indirect offering or placement of units of an AIF will be considered as marketing (including the distribution through a chain of intermediaries or a placement agent).
- In certain circumstances, providing draft AIF documentation to potential investors will not constitute marketing.

The FCA also provides the following view specifically on reverse solicitation: confirmation from the investor that the offering or placement of units of shares of the AIF was made at its initiative, should normally be sufficient to demonstrate that this is the case, provided this is obtained before the offer or placement takes place.

Are there any restrictions on managing a fund?

Fund management in the UK is regulated under the Financial Services and Markets Act 2000, various statutory instruments and the Financial Conduct Authority Rules. The Financial Conduct Authority is responsible for regulating funds, fund managers and those marketing funds and any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization.

Various restrictions arise on manager structuring/compensation and profit-sharing arrangements as a result of the regulations and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and scope and complexity of its activities. The rules impact on, among other things, reporting, equity remuneration, deferred compensation arrangements and clawback.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive (as implemented in the UK) and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the Undertakings for Collective Investment in Transferable Securities Directive. Full Financial Conduct Authority registration involves a significant authorization process – three-to-six months from completion of the application which must include:

- for the manager, information on senior personnel (must be suitable persons etc.), organizational structure, policies and procedures, remuneration practices; and
- for each fund, investment strategy, constitutional documents, depositary information and disclosure requirements.

However, AIFMs based in the UK can be exempted from full regulation on certain grounds, including managing assets under €500 million where assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers must still register with the regulator, are subject to limited reporting and it should be noted that they do not benefit from the general passporting for marketing purposes.

Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in the UK (such as a dealer) will ordinarily have to be authorized under the Financial Services and Markets Act 2000 if the transaction is one of the specified activities set
out in Part II of the Regulated Activities Order or the derivative constitutes a specified investment under Part III of the Regulated Activities Order such as:

- options;
- futures;
- contracts for difference; or
- rights to or interests in investments.

One of the key exclusions to the requirements above applies to persons who deal in derivatives for risk management purposes.

What are common types of derivatives?

The UK accounts for about half of the $640 trillion over-the-counter market derivatives market.

Derivative contracts are entered into in the UK for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in the UK:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in the UK are:

- equity;
- fixed income instruments;
- commodities;
- interest rates;
- foreign currency; and
- credit events.

Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter (OTC) derivatives have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

The European Market Infrastructure Regulation (EMIR) formed part of the European regulatory response to the global financial crisis and
sought to address the issues highlighted above. For example, EMIR requires:

- all transactions to be reported to regulators;
- some more standardised OTC transactions between certain categories of counterparties to be cleared with a central counterparty (i.e. a third party intermediary in the trade); and
- for those transactions not subject to mandatory clearing, certain other risk mitigation techniques to be applied including the posting and collection of initial margin and/or variation margin.

EMIR was amended by the EMIR Refit Regulation in June 2019 with the primary aim of simplifying certain requirements and reducing compliance costs for smaller counterparties. For example, under the EMIR Refit Regulation those categorised as ‘small non-financial counterparties’ do not need to comply with reporting and clearing requirements from specified dates.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the UK Financial Conduct Authority to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis; and
- borrowers who fall behind with their payments are dealt with.

Regulated credit agreements on the other hand have specific requirements around how the agreement is drafted and formatted and what information must be included.

There are no additional restrictions that apply to foreign lenders making loans to UK borrowers.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

What are common lending structures?

Lending in the UK can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one
of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, e.g. term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities etc.

**Loan durations**

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

**Loan commitment**

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

**Loan repayment**

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity and so requires UK Financial Conduct Authority authorization. For more information, see Lending and borrowing – restrictions.

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**Do the laws recognize the principles of agency and trusts?**

Yes, both principles are recognized as a matter of English law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

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**Are there any other notable risks or issues around lending?**
Generally

Loan agreements and other finance documents are subject to general contractual principles. For example, the England & Wales courts will not enforce a penalty and so lenders have to be careful about the rate of default interest charged on a loan. Lenders therefore tend to opt for a modest uplift of around 2% above the usual rate.

Specific types of lending

Specific to the area of mortgage lending is the issue of whether a lender falls within the recently formed UK mortgage regime. The Mortgage Credit Directive, implemented in the UK through a series of primary and secondary legislation, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Mortgage Credit Directive applies to first and second charge mortgages. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

Standard form documentation

Most English law syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA). Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write-down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Market participants should also be aware of the on-going reform of the London Interbank Offered Rate (LIBOR) and other key interest rate benchmarks. LIBOR and other reference rates are commonly used in the calculation of interest and other payments under loans as well as various other financial products. Following the United Kingdom Financial Conduct Authority’s announcement in 2017 of its intention to stop compelling banks to submit rates required to calculate LIBOR after the end of 2021, the loan market, like other financial markets, has been in a period of transition to alternative reference rates which can be used in loan and other financial contracts going forward. The expectation is that market participants, in many cases, will transition to ‘risk free rates’ (RFRs), which are mostly backward-looking overnight rates, supplemented by a spread adjustment to account for the different bases upon which LIBOR and other existing reference rates are calculated compared to the proposed RFRs. One of the key challenges for the loan market remains how to adjust the position in existing finance documents.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?
Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors’ powers that would be preventative. Under English law, directors have a general duty to promote the success of the company for the benefit of its members as whole; as such, they will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

**Insolvency**

Guarantees and security may be at risk of being set aside under England & Wales insolvency laws if the guarantee or security was granted by a company within a certain period of time prior to the onset of insolvency. This would be the case if the company giving the guarantee or security received considerably less consideration, and as such, the transaction was at an undervalue. For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within six months (or two years for connected parties) of the onset of insolvency of the affected party. Guarantees and security may also be challenged on other grounds relating to insolvency.

**Financial assistance**

It is unlawful for a public company to provide financial assistance for the purchase of its own (or of its holding company's) shares. The prohibition against financial assistance for private companies was abolished on 1 October 2008. Financial assistance in this context would include giving a guarantee or security in connection with the share purchase.

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**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees can take a number of forms.

A particular distinction worth remembering is between a performance guarantee and a payment guarantee:

- A performance guarantee is a term used to describe both performance bonds (in the context of trade finance) and ‘see to it’ guarantees (in other contexts):
  
  - A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.
  
  - A 'see to it' guarantee is a promise by the guarantor to see to it that the primary obligor fulfils its obligations under the primary contract. If the primary obligor fails to fulfil its obligations under the primary contract, the guarantor will be in breach of its obligations under the guarantee.

- A payment guarantee is narrower in scope than a performance guarantee as it only covers the payment of money rather than other contractual obligations.

**Common forms of security**

There are three basic types of security interest that can be created under English law:

- a pledge;
- a charge; and
- a mortgage.
Different types of security are suitable for securing different types of assets.

Under English law it is possible to grant security over all of the assets of an English company or individual assets. Granting security over all of a company's assets will tend to be achieved by way of a debenture which will include:

- a mortgage over real estate;
- a fixed charge over assets which are identifiable and can be controlled by the creditors (such as equipment);
- a floating charge over fluctuating and less identifiable assets (such as stock); and
- an assignment by way of charge over receivables and contracts.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing, signed by the guarantor and provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations will usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this should not be an issue. Also, it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary, for example between the borrower and lender. As a result guarantees are often executed as deeds to avoid any argument about whether good consideration was provided. Deeds have particular execution requirements under English law which need to be observed.

Additionally, there is a risk that a guarantee may be set aside if it was procured by undue influence by a borrower or lender. A party being provided with a guarantee should be alive to this issue and take steps to avoid claims of undue influence by, for example, requiring the guarantor to take separate legal advice.

Giving or taking security

A security document may need to be executed as a deed if it:

- contains a mortgage over land;
- confers a statutory power of sale and power to appoint a receiver; or
- contains a power of attorney.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the security and notice being given to third parties. Most charges created by an English company must be registered at Companies House within 21 days of its creation. Failure to register within this time means that the charge will be void against the liquidator, administrator or any creditor of the company and the money secured by the charge becomes immediately payable.

There are no notarization requirements for security documents under English law.

Like guarantees, for a period after a new security interest has been granted (known as the hardening period), it is at risk of being set aside in certain circumstances under insolvency laws. Reviewable transactions include those conducted at an undervalue, preferences and invalid floating charges.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Financial Services Act 2012
Financial Services and Markets Act 2000
Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005
FCA Handbook and PRA Rulebook

Consumer credit

Consumer Credit Act 1974 (as amended)
FCA Handbook, Consumer Credit sourcebook

Mortgages

Mortgage Credit Directive (2014/17/EU) (mortgage credit)
Mortgages and Home Finance: Conduct of Business sourcebook

Corporations

Companies Act 2006
Overseas Companies Regulations 2009

Funds and platforms

Alternative Investment Fund Managers Regulations 2013 (fund managers)

Other key market legislation

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)
Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)
European Market Infrastructure Regulation (EMIR) (Regulation (EU) 648/2012) (derivatives)
EMIR Refit Regulation (Regulation (EU) 2019/834) (derivatives)
Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)
Markets in Financial Instruments regulation (600/2014) (financial instruments)
Payment Services regulations 2017 (payment service providers)
Electronic Money Regulations 2011 (electronic money issuers)

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Regulatory authorization
Who are the regulators?

The Financial Conduct Authority (FCA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets, and also the prudential regulator for many firms. It is also responsible for enforcing the market abuse and listing regimes.

The Prudential Regulation Authority (PRA) is responsible for the prudential regulation of systemically important financial institutions, including banks, building societies, insurers and major investment firms.

What are the authorization requirements and process?

Depending on the type of firm, a firm must apply to the Financial Conduct Authority (FCA) or Prudential Regulation Authority (PRA) for authorization.

The regulators must assess whether the application meets the required threshold conditions within six months of the submission of the complete application.

The application fee depends on the type of the application ranging from £1,500 to £25,000.

The regulator will also approve key individuals (eg senior management) in their roles.

Authorized firms and individuals are listed on the FCA Register.

What are the main ongoing compliance requirements?

Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and loss of regulated status.

What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment, fines and warnings. Contracts entered into with persons who are not authorized may not be enforceable and persons may be subject to compensation in various circumstances.

Regulated activities

What finance and investment activities require authorization?

Generally

A person must not carry on a regulated activity in the UK unless authorized or exempt (known as the general prohibition).

A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in the UK and it does not fall within any of the available exclusions.
Specified activities include activities such as accepting deposits, dealing in, managing, arranging and advising on investments, and establishing collective investment schemes.

Specified investments include deposits, shares, debt instruments, options, futures, units in a collective investment scheme and government and public securities.

Consumer credit

Consumer credit activities, including credit broking, operating an electronic system in relation to lending and entering into a regulated credit agreement as lender are regulated activities.

Unless exempt agreements, these activities can only be offered by firms who are authorized and listed on the financial services register. The available exemptions relate to the nature of the agreement, the lender and the borrower, the number of repayments to be made and the total charge for credit. For example, credit agreements exceeding £25,000 that are entered into exclusively or predominantly for the purposes of the business of the borrower are exempt agreements.

Are there any possible exemptions?

There are two types of exclusions available when regulated activities may be undertaken without authorization.

General exclusions

Certain persons may carry on a regulated activity without being authorized. For example, in certain cases regulated activities carried on by overseas persons may be undertaken without authorization.

Specific exclusions

For each type of regulated activity there are a number of specific exclusions that could also apply, such as making introductions (that is, making arrangements under which clients can, under certain circumstances, be introduced to another person, who is authorized).

Do any exchange controls or other restrictions on payments apply?

The UK does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in and out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

Anti-money laundering and tax considerations may also need to be taken into account.

Payments services are regulated in the UK and must be undertaken by an authorised Payment Service Provider, such as a bank.

What are the rules around financial promotions?

A financial promotion is a communication of an invitation or inducement to engage in investment activity made by a person in the course of business. Since such communications can influence consumers, a person is restricted from communicating such promotions unless they are an authorized person, or the content of the communication has been approved by an authorized person, or the promotion falls within one of the exclusions in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

It is a criminal offence for an unauthorized person to communicate a financial promotion.
Exclusions

Exclusions include certain promotions to certified high-net worth individuals or overseas recipients, provided certain criteria are fulfilled.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are limited companies and limited partnerships, both of which are body corporates with separate legal personality and limit the liability of their members.

Limited companies can either be private (denoted by the suffix Ltd or Limited) or public (denoted by the suffix PLC or Public Limited Company) depending on whether their shares are offered to the public. Some activities require a particular type of legal entity to be used. For example, offering debt securities to the public can only be done by UK Public Limited Companies.

The liability of a company's shareholders can be limited by shares, in which case they are liable to pay for their shares but not the company's debts, or by guarantee, where they are also liable to pay a certain amount if the company is wound up.

Limited partnerships (or LLPs) are similar to limited companies in many ways, with the main differences being that they are:

- formed by partners whose relationship is governed by private agreement rather than having shareholders and directors; and
- taxed like a partnership.

Funds

Investment funds tend to take the form of limited partnerships, limited companies (including open-ended investment companies (OEICs)), unit trusts (authorized and unauthorized), UK public companies (including those approved by HMRC as UK investment trusts) and authorized contractual schemes (ACS).

Fund managers on the other hand tend to be set up as limited companies (generally limited by shares), limited liability partnerships or limited partnerships.

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A company can conduct lending or investment business in the UK through an establishment (also known as a 'branch') but this does not create a separate legal entity.

Overseas companies having a UK establishment (but which are not incorporated in the UK e.g. as a subsidiary entity) need to comply with the Overseas Companies Regulations 2009 which imposes registration, accounting, disclosure and other requirements. Such requirements do not apply to partnerships or other unincorporated entities with a similar UK presence.

Overseas companies carrying on a trade in the UK through a 'permanent establishment' will be subject to UK corporation tax.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P)-type structures, often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds, as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt, this will typically result in the platform being treated as a securitization for the purposes of the European Union Securitization Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

Blockchain, smart contracts and cryptocurrencies
WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features, such as, its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of the transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin
Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.
Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Financial Conduct Authority (FCA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets.

GENERAL

A person must not carry on a regulated activity in the UK unless authorized or exempt (known as the general prohibition). A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in the UK and it does not fall within any of the available exemptions. Where FinTech products and/or applications involve financial activity which requires regulatory authorization, the firms providing such products and/or applications must be authorized by the FCA.

PROJECT INNOVATE

In October 2014, the FCA launched an initiative known as Project Innovate with a view to encouraging innovation in the interest of consumers. Project Innovate has five initiatives:

- **regulatory sandbox** – providing businesses with access to the real market to test innovative products, services, business models and delivery mechanisms;
- **direct support** – providing a dedicated contact for innovator businesses that are considering an application for authorization or a variation to their permission;
- **advice unit** – providing regulatory feedback to firms developing automated models to deliver lower-cost advice and guidance to consumers;
- **reg tech** – encouraging technologies that may facilitate the delivery of regulatory requirements more efficiently and effectively; and
- **engagement** – providing FCA engagement with a wide variety of businesses in the UK regions and internationally.

REGULATORY DEVELOPMENTS ON INVESTMENT PLATFORMS

In March 2019, the FCA published the final report of its Investment Platforms Market Study, in response to the increasingly important role of investment platforms in the retail distribution landscape. In December 2019, the FCA published final rules for platforms to make it easier for consumers to move from one platform to another without liquidating their assets. The new rules ensure that consumers moving onto a new platform are given the option to convert to discounted units, where these are available for them to invest in. These new rules come into force on 31 July 2020.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

Since April 2014, a subsidiary of the FCA, the Payment Systems Regulator has regulated eight payment systems designated by HM Treasury, namely Bacs, Cheque & Credit, CHAPS, Faster Payment Scheme, LINK, Northern Ireland Cheque Clearing, MasterCard and Visa Europe. All participants in a designated payment system will fall under the remit of the Payment Systems Regulator, including operators that manage or operate the systems, the payment service providers using the system and the infrastructure providers to the payment system.

There are an increasing number of FinTech businesses joining these electronic payment platforms. Rules governing access to or participation in a payment system are required to be objective, proportionate and non-discriminatory. The Payment Systems Regulator is
responsible for upholding the prohibition against restrictive rules on access to payment systems. Enhanced competition is one of the objectives of the second Payment Services Directive (EU) 2015/2366 (PSD 2) which has been implemented in the UK via the Payment Services Regulations 2017.

ELECTRONIC MONEY ISSUERS

The FCA Handbook contains a number of electronic money-related rules, directions and guidance aimed at businesses that are issuing or considering the issuing of electronic money (e-money). In addition to the FCA Handbook, the law governing the issuance of electronic money is the Electronic Money Regulations 2011. E-money is defined as electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person other than the electronic money issuer and include pre-paid cards and electronic pre-paid accounts for use online. Generally, firms issuing e-money must be authorized or registered with the FCA.

PEER-TO-PEER LENDERS

A person carries out a regulated activity (requiring authorization by the FCA) if they facilitate lending and borrowing between two individuals or between individuals and businesses of less than £25,000 in circumstances where the borrower does not enter into the agreement wholly or predominantly for business purposes. Such agreements are known as Article 36H Agreements and will only be caught by the regulations where either the lender or the borrower is an individual or a partnership with two or three persons or an unincorporated body.

Regulation of payment services

Where a UK business provides payment services as a regular occupation or business activity in the UK, it will require authorization by the FCA to become an authorized payment institution under the Payment Services Regulations 2017. Failure to obtain the required authorization is a criminal offence. The regulations implement the European Union Payment Services Directive II.

In order to become authorized by the FCA as a Payment Institution, a payment services business will need to meet certain criteria, including in relation to its business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

The FCA has published an Approach Document on the FCA's role under the Payment Services Regulations 2017 and the Electronic Money Regulations 2011. It gives readers a comprehensive picture of the payment services and electronic money regulatory regime in the UK. It also provides guidance for a practical understanding of the requirements, the FCA's regulatory approach and how businesses will experience regulatory supervision.

Application of data protection and consumer laws

The UK's Data Protection Act 1998 (DPA) regulates the processing of personal data within the UK. The DPA implements the European Data Protection Directive. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the DPA and have certain notification and compliance obligations.

The European General Data Protection Regulation (EU) 2016/679 (GDPR) came into effect on 25 May 2018. As a result of GDPR, the DPA has been amended and replaced with the Data Protection Act 2018. The GDPR is more prescriptive and restrictive, compared to the principles-based DPA, including mandatory notifications where a breach occurs and provide for severe monetary sanctions for breach. GDPR sets the key principles, rights and obligations for most processing of personal data. As a European Regulation, it has direct effect in UK law and automatically applies in the UK until the UK leaves the EU. After this date (Brexit), GDPR will continue to apply in the UK as a result of the European Union (Withdrawal) Act 2018, with some technical changes to make it work effectively in a UK context.

The UK's Privacy and Electronic Communications Regulations 2003 (PECR) regulate unsolicited direct marketing by electronic means, in addition to sector specific regulations, such as the FCA's financial promotions regime. PECR has been updated in light of GDPR and uses a new standard of GDPR consent.

Money laundering regulations

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 give the FCA responsibility
for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment.

Generally, where a firm is authorized and supervised by the FCA it will also be authorized and supervised by the FCA for complying with anti-money laundering requirements.

The MLRs have been updated to implement the Fifth Anti-Money Laundering Directive (EU) 2018/843. These changes include bringing into scope of the MLRs the following firms:

- cryptoasset exchange providers (including Cryptoasset Automated Teller Machine (ATM), Peer to Peer Providers, Issuing new cryptoassets, e.g Initial Coin Offering (ICO) or Initial Exchange Offerings); and
- custodian wallet providers.

Electronic currencies such as bitcoin and other cryptocurrencies tend to represent a higher money-laundering risk. Cryptoasset exchange providers and custodian wallet providers are required to register with the FCA and comply with the MLRs.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals, (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdcube or Crowdfunder.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

There are various incubators or accelerators in the UK market, which offer support, facilities and funding for startups, often in return for an equity stake. For example, Barclays has an accelerator program which offers up to US$120,000 investment from Techstars, together with mentoring from industry experts.

Venture capital and debt

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund, examples of which include Santander InnoVentures and Citigroup's Citi Ventures. The benefit of having a CVC as an investor for a FinTech startup is that the
An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, such as Zopa and Funding Circle, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments; interest is paid on the money borrowed instead.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

The UK has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) is a popular funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the London Stock Exchange. The London Stock Exchange's Alternative Investment Market (AIM) caters specifically for small, growth-orientated companies.

A number of marketplace loan securitizations have been launched in the UK, where loans originated via marketplace lending platforms are packaged together and sold to investors as bonds by companies such as Funding Circle and Zopa.

FinTech companies have also accessed funding by issuing bonds to retail investors as a way of raising more competitive funding. For example, in July 2017 LendInvest issued an initial £50 million of retail bonds, which are tradeable on the LSE.

**CONVERTIBLE BONDS/LOAN NOTES**

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes, which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

**Incentives and reliefs**

The Seed Enterprise Investment Scheme (SEIS) is designed to help small, early-stage companies raise equity finance by offering 50% income tax relief for individuals who invest in the shares of qualifying startups, up to a maximum investment of £100,000 per annum. This scheme complements the Enterprise Investment Scheme (EIS), which offers a lower rate of income tax relief of 30% to investors in higher-risk small companies. It is worth noting that some financial activities, such as money lending or insurance are non-qualifying trading activities, and as such, EIS and SEIS may not be available for all FinTech companies.

In addition, research and development (R&D) tax credits are an incentive designed to encourage companies to invest in R&D. SME
businesses (those with fewer than 500 employees, and either revenue less than €100 million or balance sheet assets less than €86 million) can benefit from up to 230% tax relief on their R&D expenditure.

The Patent Box Scheme enables companies to apply lower rate of Corporation Tax (10%) to profits earned from its patented inventions.

Finally, since 6 April 2017, payments of interest made by a UK borrower to a UK lender through a UK peer-to-peer platform are exempt from withholding tax provided that certain conditions are met. To avail the exemption, the credit provided by the lender to the borrowers needs to have been provided at the invitation of a regulated operator of an electronic system.

Portfolio sales

Loan transfers and portfolio sales

_What are common ways of buying and selling loans?_

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party’s rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

- **Assignment** – An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. An assignment can be effected as either an equitable assignment or legal assignment depending on whether certain statutory requirements have been satisfied.

- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

_What are the main considerations when transferring a loan and related security?_

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller’s legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;

- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;

- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;

- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and

- **consent** – whether a transfer requires the consent or notification of any other parties.
Projects

Financing / investing in energy / infrastructure

*To what extent are energy and infrastructure assets publicly or privately owned?*

**Generally**

The ownership of energy and infrastructure assets in the UK varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

The UK government has announced that Private Finance Initiative (PFI) or Public Private Partnership (PPP) models may no longer be utilised in England and Wales. Until this policy is changed, investment and lending opportunities are therefore likely to be found in economic infrastructure with the exception of some opportunities in the social housing sector. The Welsh and Scottish government continue to utilise PPP-style models on certain projects using the Mutual Investment Model (MIM) and the Non-Profit Distributing (NPD) model respectively.

Key sectors are considered below.

**Energy**

The gas and electricity industries in the UK are privatized, with the generation, transmission, distribution and supply services provided by a number of private sector companies. The relevant private sector companies own the generation, transmission and distribution assets. Notably, the National Grid, a listed public company (albeit heavily regulated) owns all of the mainland transmission lines. On certain offshore projects, private entities other than the National Grid may own transmission lines.

The private sector finances and delivers most of the required infrastructure but there are a number of government policy mechanisms (adopted through legislation) which are used to incentivize investment in eligible energy generation technologies. In certain instances, including on major energy infrastructure, projects may be procured by the public sector and depending on the terms of the procurement, the asset may either be publicly or privately owned.

The Office of Gas and Electricity Markets (Ofgem) (as governed by the Gas and Electricity Markets Authority) is the principal body with responsibility for regulation of the energy sector in Great Britain. There is a separate regulator (the Utility Regulator) for the energy sector in Northern Ireland.

**Telecoms infrastructure**

The telecommunications networks (fixed and mobile) in the UK are privately owned by a number of service providers. A good example is BT Openreach which is responsible for most of the UK’s broadband infrastructure but whose work is heavily regulated by government; it, in turn, works with more than 500 service providers to provide local access to users.

The Office of Communications (Ofcom) is the regulator of the UK’s telecommunications sector. It also has responsibilities for television broadcast services and wireless communications services.

Due to the UK government’s focus on driving the digital transformation through enhanced telecommunications, recent years have seen Ofcom seek to address the issue of BT Openreach’s strong position in the broadband access market by attempting to level the playing field in terms of access of BT Openreach’s own network and infrastructure to other private providers and making it easier for such providers to build their own broadband networks. As a result, there has been an expansion of other providers building their own networks.

There has also been significant M&A activity in the ownership of telecommunications towers.
Transport infrastructure

LIGHT RAIL

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies. For example, Transport for London owns the tubes, track and supporting infrastructure in London. Outside of London and on a small number of lines on the London Underground network, certain elements of light rail projects may be outsourced to the private sector; for example, the private sector may provide new trams, run a concession or operate and maintain a light rail system on behalf of a local transport executive – the assets will continue, however, to be owned by the public sector.

HEAVY RAIL

The rail market in the UK is privatized but its composition (which is complex) involves both public and private entities. The principal elements to the rail sector in Great Britain are:

- **Network Rail**, a private limited company, is on the public sector balance sheet and owns, operates and maintains rail tracks, signaling and station infrastructure. It is responsible for improving most of the regulated national rail infrastructure and for operating some of the stations on the national rail network. It is not responsible for the London Underground network, Crossrail and High Speed rail infrastructure.

- **Public transport authorities**, ie central and devolved government bodies and some metropolitan bodies, specify, let and manage operating contracts and give Network Rail a significant proportion of the funding for infrastructure maintenance and enhancement.

- **Train operating companies (TOCs)** are awarded franchises by the Department for Transport or local transport executives to operate certain train lines. 'Open Access TOCs' may apply to the rail regulator for use of certain train paths/routes when not being used by the franchised TOCs. Note that the UK government is currently reviewing the franchise system.

- **Freight operating companies (FOCs)** are wholly commercial entities.

- **Rolling stock companies (ROSCOs)** are private entities which own and maintain rolling stock and lease them to the TOCs for use on their franchise.

- **Project finance** – There have been limited deals (for example both phases of the Intercity Express Programme) where rolling stock has been procured through a PFI (Private Finance Initiative) / PPP (Public Private Partnership) project finance-style model and on that deal it is the private sector which owns the trains and will continue to do so following the expiry of the main contract with the public sector. The Thameslink rolling stock PPP also deployed elements of a PFI-style model albeit in a hybrid PFI/asset finance structure. Project finance structures have been utilised on other deals but they have tended to adopt alternative ownership and revenue models rather than a direct PFI-style availability model.

The rail sector is regulated by the Office of Rail and Road (ORR).

ROADS, BRIDGES AND TUNNELS

A government entity, Highways England, operates, maintains and improves the motorways and major ‘A’ roads (ie the strategic road network) in England. Highways England is regulated by the Office of Road and Rail and receives funding from the government for investment in the strategic road network (including additional road capacity). Local roads in England are the responsibility of local authorities. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. In the case of tolled roads, the private sector has taken on roads/crossings on a full concession basis – namely, responsible for the design, build, financing, operation, maintenance and collection of tolls for a number of years with the main revenue stream being the collection of toll revenues from users (rather than any service payments from the public sector) but these types of projects are no longer considered viable as the private sector is not willing to take ‘demand risk’ in order to service the upfront capital costs and associated bank debt. On more recent projects, the private sector provides toll collection services (in part) for a service fee rather than it solely relying on those tolls as its main source of revenue.

AVIATION

Aviation in the UK is (for the most part) privatized. As regards airport infrastructure, there are a number of ownership structures in the UK market, including private ownership, local government ownership and various forms of public-private ownership. All models are heavily regulated by government and the Civil Aviation Authority is the aviation regulator in the UK.
PORTS

The UK ports sector comprises a variety of company, trust and municipal ports, all operating on commercial principles, independently of government and largely without public subsidy. The private sector operates the vast majority of the UK’s major ports.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES HUBS AND PRISONS)

Typically, these are owned by the public sector with the exception of social housing projects (please see below) with the private sector’s responsibility being for any or all of the design, build, financing, operation and maintenance of the infrastructure. The majority of social infrastructure assets in the UK are directly financed by the government. Subject to value for money considerations, historically private finance may also have been considered in the procurement of social infrastructure assets using the Private Finance Initiative and its successor, Private Finance 2 (PF2). However, the UK government has declared that PFI, PF2 or any other Public Private Partnership (PPP) model may not be used going forward. This means that likely financing model for future projects is through direct financing by government unless there is a change of policy. In relation to some of these specific sectors:

Education

The ownership of a school's infrastructure depends upon which category of school it belongs to. For example, in the case of a local authority maintained school, the school and playing fields will be owned by the local authority; and an academy school (which receives funding directly from the government) may lease land from a local authority.

Hospitals

Ownership of hospitals is vested in various public sector bodies operating within the National Health Service.

Social housing

This is a diverse sector involving many different organizations and individuals including housing developers, building contractors, mortgage lenders, local authorities, housing associations, landlords, owner-occupiers, private renters and those in the social rented sector. Typically, on a social housing project, housing associations own the relevant housing stock. Although housing associations tend to be private limited companies their governance is constrained by public sector regulation and, effectively, operate as quasi-public sector entities.

DEFENSE

Typically, defense assets are owned by the public sector.

WASTE

In the past, the public sector procured new waste treatment or collection facilities and these were owned by the public sector even if the private sector would be responsible for design, build, operation or maintenance of the facility. One example being long-term Private Finance Initiative (PFI) contracts with private sector companies in relation to the building and operation of waste infrastructure, with financial support being provided to the local authorities by the government through the PFI in respect of the cost of those projects. Increasingly, merchant facilities, namely those developed and operated by private sector entities, are being used and these facilities serve both their public sector and private sector customers. According to the Infrastructure and Projects Authority's National Infrastructure Delivery Plan 2016-2021 (March 2016), the government is not planning to fund any new waste infrastructure projects beyond those in the pipeline.

WATER

Water and wastewater (sewerage) services in England and Wales are delivered by private sector companies (water companies) which own the relevant infrastructure assets. In Scotland and Northern Ireland, water and wastewater services are provided by state owned companies. The Thames Tideway Tunnel (a major new sewer) in London is being built and will be operated by a private sector company called Tideway, which is independent of Thames Water (the regional water company). The Water Services Regulation Authority (Ofwat) is the regulator of the water sector in England & Wales. The Northern Ireland Authority for Utility Regulation (NIAUR) is the regulator for Northern Ireland. The Water Industry Commission for Scotland (WICS) is the equivalent for Scotland.
Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in the UK over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body (eg a government department, a local authority or a National Health Service Trust) is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval. Key sector-specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on ‘Change of Control’. This is less of a concern on private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy markets in the UK have a complex system of arrangements between suppliers, generators, transmission and distribution which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customer and the National Grid and these are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.

Telecoms infrastructure

There is a complex regulatory environment for this sector including how access and interconnectors (between networks) are regulated under the Digital Economy Act 2017, Communications Act 2003 and the Communications (Access to Infrastructure) Regulations 2016 and how Ofcom grants rights to access private or public land in order to install and maintain essential equipment in, over or under that land. This equipment might be cables sunk beneath the ground or a mobile mast sited on the ground.

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

Transport infrastructure

RAIL

There is an extensive and complex regulatory framework to consider in respect of a practical and operational involvement in this sector. Key areas include understanding the regulatory regime for certification for train use and acceptance and user fare regulation. Depending on how an investor wishes to invest in a project (specifically what type of entity or asset), there is a varying degree of difficulty for investors to enter into an existing project. For example, rolling stock operating companies (ROSCOs) are privately owned companies where third party investment is relatively common whereas train operating companies (TOCs) are often special purpose vehicles so, in theory, investment into a TOC should be relatively straightforward. However, any change in control of a TOC under a Franchise Agreement will usually require a consent from the Department for Transport. Note that the UK government is currently reviewing its policy on rail franchising and the market is expecting changes to be made to the current model.

ROADS
In order for a private sector partner to carry out its duties on certain types of roads projects, the procuring public sector authority (Highways Agency or a local authority) may delegate certain of its statutory duties to the private sector partner. This will be dependent on the project and the specific contractual requirements. Any investor will, therefore, need to understand those duties and whether it is able to subcontract those duties to an appropriate person. There is usually a restriction on the change of control of the private sector partner during the construction period. Following the construction period, the private sector may be allowed a change of control provided that they do not fall within a definition of an ‘Unsuitable Third Party’ (which may include concerns about national security, tax avoidance). The precise scope of the restrictions will depend on the contractual terms.

**Other infrastructure**

On publicly-procured infrastructure, it is quite common for long-term projects to have a ‘change in control’ clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the construction period but this is often relaxed post construction provided any change in control is not to an ‘Unsuitable Third Party’. How strict these restrictions are will often depend on the sector. For example, the defense sector usually gives the Ministry of Defence a strong degree of discretion (particularly on the grounds of national security) as to whether to accept a change in control over its private sector partner.

Last modified 6 Dec 2019

**What is the applicable procurement process?**

Public procurement in England & Wales is, for the time being, in most instances governed by the Public Contracts Regulations 2015 which is based on EU Directives. There are some sector-specific regulations such as the Utilities Contract Regulations 2016 (applicable to the rail sector, water and energy) and the Defence and Security Public Contracts Regulations 2011 (which are also based on EU Directives and therefore this entire framework is subject to change as the UK leaves the EU).

The key principles are that any contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

**Investing in energy and infrastructure**

Public procurement is relevant where the UK government, or a branch of it, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to certain public bodies including central government departments, local authorities, police and fire authorities, NHS Trusts, various non-governmental bodies such as the Competition and Markets Authority and the House of Commons. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer’s bid.

- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been
procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

**Financing energy and infrastructure**

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector and any refinancing gains to be shared with the public sector.

*Last modified 6 Dec 2019*

**What are the most common forms of funding / investing in energy and infrastructure?**

The principal forms of private sector funding/investment in energy and infrastructure in the UK (including in relation to public-private partnerships) are:

**Funding**

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders. For publicly procured project financed deals, this has traditionally meant using the PF2 or Private Finance Initiative (PFI) model since the UK government announced that such models can no longer be used, the market had adapted to provide financing on private sector-initiated energy and infrastructure projects;
- syndicated to other funders. (For publicly procured project financed deals, this often means using the PF2 model which is a successor to the Private Finance Initiative (PFI));
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing this is particular relevant in the rail sector.

Funding/funding products can also, sometimes, be provided by the European Investment Bank and export credit agencies.

**Investing**

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of ‘equity”).

*Last modified 6 Dec 2019*

**Restructuring**

**Enforcement and sanctions**

*When can there be regulatory investigations?*
When the Financial Conduct Authority or the Prudential Regulatory Authority considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

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**What regulatory penalties may apply?**

When a rule breach has taken place, the Financial Conduct Authority or the Prudential Regulatory Authority have a variety of regulatory penalties they may impose depending on the seriousness of the matter. These include:

- withdrawing a firm's authorisation;
- prohibiting individuals from carrying on regulated activities;
- suspending firms and individuals from undertaking regulated activities;
- issuing fines against firms and individuals who breach the rules or commit market abuse such as insider dealing;
- issuing fines against firms breaching competition laws;
- making a public announcement and publishing details of a warning, decision or final notices;
- applying to the courts for injunctions, restitution orders, winding-up and other insolvency orders;
- bringing criminal prosecutions for financial crime, such as insider dealing, unauthorised business and false claims to be authorised; and
- issuing warnings and alerts about unauthorised firms and individuals and requesting that web hosts deactivate associated websites.

**Last modified 6 Dec 2019**

**What criminal penalties may apply?**

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the Money Laundering Regulations; and
- conducting regulated activities when not authorized.

**Last modified 6 Dec 2019**

**Tax**

**Tax issues**

*Are stamp, registration, transfer or other similar taxes applicable?*

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

**Advance of loan**

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

**Transfer or assignment of a debt under a loan**

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When the Financial Conduct Authority or the Prudential Regulatory Authority considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

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**What regulatory penalties may apply?**

When a rule breach has taken place, the Financial Conduct Authority or the Prudential Regulatory Authority have a variety of regulatory penalties they may impose depending on the seriousness of the matter. These include:

- withdrawing a firm's authorisation;
- prohibiting individuals from carrying on regulated activities;
- suspending firms and individuals from undertaking regulated activities;
- issuing fines against firms and individuals who breach the rules or commit market abuse such as insider dealing;
- issuing fines against firms breaching competition laws;
- making a public announcement and publishing details of a warning, decision or final notices;
- applying to the courts for injunctions, restitution orders, winding-up and other insolvency orders;
- bringing criminal prosecutions for financial crime, such as insider dealing, unauthorised business and false claims to be authorised; and
- issuing warnings and alerts about unauthorised firms and individuals and requesting that web hosts deactivate associated websites.

**Last modified 6 Dec 2019**

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- breaches of the Money Laundering Regulations; and
- conducting regulated activities when not authorized.

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**Transfer or assignment of a debt under a loan**

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A written instrument transferring or assigning a debt under a loan is, in principle, chargeable to 0.5% UK stamp duty. An agreement to transfer a debt is also, in principle, chargeable to UK stamp duty reserve tax (SDRT) (although, in practice, a payment of both UK stamp duty and SDRT should not be required). However, provided the debt constitutes loan capital and does not have certain offensive features (such as a right to interest exceeding a commercial return or a right to conversion into shares or other securities), the written instrument assigning or transferring, or the agreement to assign or transfer, such debt should be exempt from both UK stamp duty and SDRT. This is known as the loan capital exemption.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There is no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security.

However, most security interests created by English companies and English limited liability partnerships must be registered at Companies House to perfect the security and ensure it is valid against third parties. The grant of most security interests over UK real estate should also be registered at the Land Registry (in the case of real estate in England and Wales) and the Scottish Land Registry (in the case of real estate in Scotland) to ensure that the security interest takes effect as a legal charge. It would be unusual for the fees payable for such registrations to be a material amount.

Other forms of registration may also be required (or be advisable), depending on the nature of the asset over which security is taken. Such registrations may also require the payment of fees.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

ISSUE OF DEBT SECURITIES

Bearer bonds

The issue of a debt security in the UK which is a bearer bond or the issue by or on behalf of a UK company of a debt security which is a bearer bond, in principle, gives rise to a charge to UK bearer instrument duty (BID). Such BID is chargeable at a rate of 1.5% of the issue price of the bearer bond. However, currently, HM Revenue and Customs is not seeking to collect BID on the issue of a debt security which is a bearer bond.

Registered bonds

Subject to the special regime for issues into a depository or clearing system (see below), there is generally, no charge to UK stamp duty or SDRT on the issue of a debt security which is a registered bond. The issue of a debt security which is a registered bond should also not give rise to a charge to BID (which is only relevant to bearer instruments).

TRANSFER OF BONDS

Bearer bonds

The first transfer in the UK of a debt security which is a bearer bond issued outside of the UK by a non-UK company, in principle, gives rise to a UK bearer instrument duty charge (if stamp duty would have been payable on the instrument of transfer if the bond had been in registered form). Such BID is charged at a rate of 1.5% of the transfer consideration. UK stamp duty only applies in respect of written instruments of transfer and so is not, normally, relevant to the transfer of a debt security which is a bearer bond, provided it is transferred by delivery. However, any agreement to transfer a bearer bond issued by or on behalf of a UK company is, in principle, chargeable to SDRT. Such SDRT is charged at a rate of 0.5% of the transfer consideration.

Registered bonds

A written instrument transferring a debt security which is a registered bond is, in principle, chargeable to UK stamp duty if the instrument is executed in the UK, or relates to UK stock or marketable securities or to something done, or to be done, in the UK. Any agreement to transfer a debt security which is a registered bond issued by a UK company or registered in a UK register is also, in principle, chargeable to SDRT. Such UK stamp duty and SDRT are chargeable at a rate of 0.5% of the transfer consideration.

DEPOSITORY AND CLEARING SYSTEMS
**Bearer bonds and registered bonds**

A written instrument transferring certain debt securities to a person whose business is, or includes, issuing depositary receipts or the provision of clearance services for chargeable securities (or the agent or nominee of such a person) is, in principle, chargeable to UK stamp duty. Such stamp duty is generally chargeable at a rate of 1.5% of the consideration or market value of the debt securities (depending on the circumstances).

The issue or transfer of certain debt securities to a depositary receipt issuer (or its nominee), where a depositary receipt is issued or to be issued, or the issue or transfer of debt securities into a clearing system (or its nominee) in pursuance of an arrangement for the provision of clearance services, in principle, gives rise to a charge to SDRT. Such SDRT is generally chargeable at a rate of 1.5% of the issue price, consideration or market value of the debt securities (depending on the circumstances). However, currently, HM Revenue and Customs is not seeking to collect SDRT on the issue, or (where integral to the raising of capital) the transfer, of debt securities into a clearing system or depositary receipt system, provided that the debt securities comprise loans raised by the issue of debentures or other negotiable securities for the purposes of Article 5(2)(b) of the Capital Duty Directive (2008/7/EC).

**EXEMPTIONS**

While in some circumstances, both UK stamp duty and SDRT may apply to the same transaction, as a general principle, there should be no double charge due to the operation of a franking system.

If a debt security benefits from the loan capital exemption, the issue or transfer of such debt security (whether a bearer bond or registered bond) should not be chargeable to UK stamp duty, BID or SDRT. The loan capital exemption applies to loan capital that does not have certain offensive features (such as a right to interest exceeding a commercial return or a right to conversion into share or other securities). The loan capital exemption is therefore the key exemption in the context of capital markets transactions and serves to exempt most vanilla bonds entirely from UK stamp taxes.

**Do tax authorities take priority on enforcement?**

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g., secured bond holders)?

Secured lenders and secured debt security holders take priority over HM Revenue and Customs on enforcement of security.

**Is withholding tax on interest payments applicable?**

Is there withholding tax on interest payments under a loan?

Unless an exemption applies, where a payment of interest with a UK source is paid under a loan which is intended or expected to have a duration of a year or more, an amount equal to the basic rate of the interest payment is required to be withheld and paid to HM Revenue and Customs.

If so:

**What is the rate of withholding?**

The current rate of UK withholding tax (i.e., the basic rate) is 20%.

**What are the key exemptions?**

The most commonly relied on exemptions to ensure that interest payments made by UK companies can be made free of UK withholding tax include:

- the exemption for interest paid on an advance from a UK tax resident bank;
• the UK-to-UK exemption (applicable where interest is paid to a lender which is a UK tax resident company or a partnership of such companies);
• the quoted Eurobond exemption (applicable to interest paid on a security which is listed on a recognized stock exchange);
• reliance on a double tax treaty (such treaty may only provide for partial exemption);
• the qualifying private placement (the key requirement being the residence of the lender in a qualifying double tax treaty jurisdiction);
• reliance on the EU Interest and Royalties Directive as implemented by UK law (the key requirement being that the lender and the borrower meet the association requirement).

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

The quoted Eurobond exemption is particularly relevant to debt securities.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Key contacts

Sarah Day
Partner
DLA Piper UK LLP
sarah.day@dlapiper.com
T: +44 (0)113 369 2104
UK - Scotland

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both UK and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in the UK or to request that they are admitted to trading on a regulated market operating in the UK unless an approved prospectus has been made available to the public.

The International Capital Market Association has published standard form selling restrictions for offers of debt securities in the UK. These restrictions are aimed at preventing a breach of:

- the rules on financial promotion; and
- the rules on accepting deposits in the UK.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in the UK are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in the UK. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (ie debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
• warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

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**What are the differences between offering debt securities to institutional/professional or other investors?**

The Prospectus Directive does not make a distinction between professional and other investors for the purposes of its disclosure requirements but does include different disclosure regimes by reference to the minimum denomination of a single security.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the 'wholesale' rules apply. If the denomination is under €100,000, the 'retail' rules apply. Additional disclosure requirements apply for retail securities.

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**When is it necessary to prepare a prospectus?**

Under the Prospectus Directive, unless an exemption applies, it is necessary to publish a prospectus where there is an offer of securities to the public or an application for the securities to be admitted to trading on a regulated market.

An offer would not be deemed to have been made to the public if it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per European Economic Area state or where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a Prospectus Directive compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

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**What are the main exchanges available?**

The London Stock Exchange has two principal markets on which debt securities are traded:

• the Main Market; and

• the Professional Securities Market.

**The London Stock Exchange Main Market**

The Main Market is a regulated market for the purposes of the Markets in Financial Instruments Directive (MiFID), so issuers on the Main Market are subject to the requirements of a number of EU Directives, including the Market Abuse Directive and the Transparency Directive. Securities listed on the Main Market can be passported to other European Economic Area markets in order to access international investors.

**The London Stock Exchange Professional Securities Market**

The Professional Securities Market is an exchange regulated market subject to the rules of the London Stock Exchange. It is not a regulated market for the purposes of MiFID and therefore provides a more flexible alternative to the requirements regarding denomination and financial information, compared to the rules which apply to regulated markets across Europe. As it permits reporting under national Generally Accepted Accounting Principles (GAAP), it offers an alternative for issuers not wishing to prepare financial information to International Financial Reporting Standards (IFRS).

The London Stock Exchange also operates the Order Book for Retail Bonds, which is an electronic trading platform for debt securities that are issued in denominations of less than £100,000 and listed on the Main Market.

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Is there a private placement market?

The UK has an active private placement market.

There is no dominant standard for documentation but efforts have been made by the Loan Market Association and International Capital Markets Association to standardize private placement documentation.

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Scots law. The UK has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the Financial Services and Markets Act 2000 and therefore subject to regulation by the UK Financial Conduct Authority.

Collective Investment Schemes

The regulations apply to activities undertaken in relation to 'Collective Investment Schemes' which are schemes comprising the following arrangements (subject to certain specific exceptions set out in the legislation):

- with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income;

- where the participants do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions; and

- that have either or both of the following characteristics:

  - pooling of investors' contributions and profits or income; and

  - the property is managed as a whole by or on behalf of the operator of the scheme.
What are common fund structures?

Common forms of funds include:

- open-ended (UK Authorized Unit Trusts (AUTs), Investment Companies with Variable Capital (ICVCs) and Authorized Contractual Scheme (ACSs)) and closed-ended funds;
- retail and non-retail funds (including Alternative Investment Funds (AIFs));
- Undertakings for Collective Investments in Transferable Securities (UCITS) and non-UCITS funds; and
- qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

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What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Open-end retail funds must be either authorized by the UK Financial Conduct Authority (if UK domiciled) or recognized by the Financial Conduct Authority (if domiciled in another jurisdiction). Funds that are ‘recognized’ by the Financial Conduct Authority in this context mostly comprise Undertakings for Collective Investment in Transferable Securities (UCITS) funds established in other jurisdictions. Closed-end retail funds that are listed in the London Stock Exchange Main Market or specialist funds market are not ‘authorized’ by the Financial Conduct Authority, but the listing itself requires approval by the Financial Conduct Authority in its capacity as the UK listing authority.

Retail funds, including UCITS, are subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depositary arrangements for assets, investment and borrowing powers specifications (for open-end retail funds), concentration requirements and other matters.

Institutional/professional funds

In practice, non-retail funds (other than limited partnerships) are usually established outside the UK because there are no UK non-retail tax-exempt fund vehicles (other than unauthorized unit trusts that are only offered to UK tax-exempt investors).

Closed-end funds are generally established as UK or offshore limited partnerships and open-end funds such as hedge funds are typically established as companies and unit trusts.

Non-retail funds that are offered in the UK generally fall into the category of Alternative Investment Funds (AIFs) and therefore subject to the Alternative Investment Fund Managers Directive regime in relation to authorization of the manager/fund, marketing arrangements, reporting, governance etc.

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Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Separately managed accounts are also commonly used in the UK as an investment management structure – investor funds are generally held in a separate account subject to the discretionary investment authority of a manager who can acquire and dispose of assets using the investor funds in line with a pre-determined strategy and parameters set out in an Investment Management Agreement. These are often also structured as ‘funds of one’.

Managing investments is a regulated activity under the UK Financial Conduct Authority rules and therefore subject to authorization;
however, managed accounts and 'funds of one' themselves are generally not classed as (and therefore avoid the regulatory restrictions in being classed as) Collective Investment Schemes or Alternative Investment Funds.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

UK selling restrictions

Generally in the UK, offering securities is either covered under the UK Financial Conduct Authority’s financial promotion regime, under the Undertakings for Collective Investment in Transferable Securities Directive regime or under the Alternative Investment Fund Managers Directive.

Undertakings for Collective Investments in Transferable Securities (UCITS)

UCITS, including those established in the UK, have a EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Managers Directive, marketing is defined as: a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).

Reverse solicitation and the definition of ‘marketing’

Applicable in the context of professional investors, this is a sensitive area in the UK and Europe generally. The Alternative Investment Fund Managers Directive generally continues to permit professional investors who wish to invest in AIFs based on their own initiative (reverse solicitation); however, the EU is currently reviewing this area during 2017 and may impose tighter requirements.

Specifically in the UK, the Financial Conduct Authority has provided broad guidance on the definition of ‘marketing’ as follows:

- Marketing will, generally, not include secondary trading in the units of an AIF. Therefore, the listing of AIF units will not necessarily constitute marketing.
- The indirect offering or placement of units of an AIF will be considered as marketing (including the distribution through a chain of intermediaries or a placement agent).
- In certain circumstances, providing draft AIF documentation to potential investors will not constitute marketing.

The FCA also provides the following view specifically on reverse solicitation: confirmation from the investor that the offering or placement of units of shares of the AIF was made at its initiative, should normally be sufficient to demonstrate that this is the case, provided this is obtained before the offer or placement takes place.

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Are there any restrictions on managing a fund?

Fund management in the UK is regulated under the Financial Services and Markets Act 2000, various statutory instruments and the Financial Conduct Authority Rules. The Financial Conduct Authority is responsible for regulating funds, fund managers and those marketing funds and any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization.

Various restrictions arise on manager structuring/compensation and profit-sharing arrangements as a result of the regulations and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and scope and complexity of its activities. The rules impact on, among other things, reporting, equity remuneration, deferred compensation arrangements and clawback.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive (as implemented in the UK) and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the Undertakings for Collective Investment in Transferable Securities Directive. Full Financial Conduct Authority registration involves a significant authorization process – three-to-six months from completion of the application which must include:

- for the manager, information on senior personnel (must be suitable persons etc), organizational structure, policies and procedures, remuneration practices; and
- for each fund, investment strategy, constitutional documents, depositary information and disclosure requirements.

However, AIFMs based in the UK can be exempted from full regulation on certain grounds, including managing assets under €500 million where assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers must still register with the regulator, are subject to limited reporting and it should be noted that they do not benefit from the general passporting for marketing purposes.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in the UK (such as a dealer) will ordinarily have to be authorized under the Financial Services and Markets Act 2000 if the transaction is one of the specified activities set out in Part II of the Regulated Activities Order or the derivative constitutes a specified investment under Part III of the Regulated Activities Order such as:

- options;
- futures;
- contracts for difference; or
- rights to or interests in investments.

One of the key exclusions to the requirements above applies to persons who deal in derivatives for risk management purposes.

The European Market Infrastructure Regulation applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

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What are common types of derivatives?

The UK accounts for about half of the $600 trillion over-the-counter market derivatives market.
Derivative contracts are entered into in the UK for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in the UK:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in the UK are:

- equity;
- fixed income instruments;
- commodities;
- foreign currency; and
- credit events.

**Are there any other notable risks or issues around entering into derivatives contracts?**

Since the global financial crisis in 2007 to 2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

**Debt finance**

**Lending and borrowing**

**Are there any restrictions on lending and borrowing?**

**Lending**

Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the UK Financial Conduct Authority to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular restrictions around how:

- the loans are marketed, originated and sold;
• lenders administer the loans on an ongoing basis; and

• to deal with borrowers who fall behind with their payments.

Regulated credit agreements on the other hand have specific requirements around how the agreement is drafted and formatted and what information must be included.

There are no additional restrictions that apply to foreign lenders making loans to UK borrowers.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

What are common lending structures?

Lending in the UK can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities etc.

Loan durations

The duration of a loan can also vary between:

• a term loan, provided for an agreed period of time but with a short availability period;

• a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;

• an overdraft, provided on a short-term basis to solve short-term cash flow issues; or

• a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

• committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or

• uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).
What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity and so requires UK Financial Conduct Authority authorization. For more information, see Lending and borrowing – restrictions.

Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of Scots law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. For example, the Scottish courts will not enforce a penalty and so lenders have to be careful about the rate of default interest charged on a loan. Lenders therefore tend to opt for a modest uplift of around 2% above the usual rate.

Specific types of lending

Specific to the area of mortgage lending is the issue of whether a lender falls within the recently formed UK mortgage regime. The Mortgage Credit Directive, implemented in the UK through a series of primary and secondary legislation, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Mortgage Credit Directive applies to first and second charge mortgages. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

Standard form documentation

Although not a regulatory requirement, most Scots law syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA). Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.
The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to ‘bail in’ obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. ‘Bail in’ describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative. Under Scots law, directors have a general duty to promote the success of the company for the benefit of its members as whole; as such, they will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

Insolvency

Guarantees and security may be at risk of being set aside under Scottish insolvency laws if the guarantee or security was granted by a company with a certain period of time prior to the onset of insolvency. This would be the case if the company giving the guarantee or security received considerably less consideration, and as such, the transaction was at an undervalue. For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within six months (or two years for connected parties) of the onset of insolvency of the affected party. Guarantees and security may also be challenged on other grounds relating to insolvency. Note that where a guarantee is given to a related company, the circumstances in which it can be set aside are far wider and, in particular, there is no requirement in these circumstances that the chargor was insolvent at the time the guarantee was given.

Financial assistance

It is unlawful for a public company to provide financial assistance for the purchase of its own (or of its holding company's) shares. The prohibition against financial assistance for private companies was abolished on 1 October 2008. Financial assistance in this context would include giving a guarantee or security in connection with the share purchase.

What are common types of guarantees and security?

Common forms of guarantees

Guarantees can take a number of forms.

A particular distinction worth remembering is between a performance guarantee and a payment guarantee:

- A performance guarantee is a term used to describe both performance bonds (in the context of trade finance) and ‘see to it’ guarantees (in other contexts).
A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.

A ‘see to it’ guarantee is a promise by the guarantor to see to it that the primary obligor fulfils its obligations under the primary contract. If the primary obligor fails to fulfil its obligations under the primary contract, the guarantor will be in breach of its obligations under the guarantee.

A payment guarantee is narrower in scope than a performance guarantee as it only covers the payment of money rather than other contractual obligations.

Common forms of security

The law of Scotland differs greatly from that in England and Wales in relation to the forms of security which can be taken over assets located in Scotland. Scots law does not recognize a distinction between equitable and legal charges. In general, Scottish security can be taken over a much more limited range of assets than is the case in England and Wales and there is no overarching security document which would replicate an English debenture. The main forms of security available in Scotland are as follows.

STANDARD SECURITY

This is the equivalent of an English legal mortgage and relates to security over heritable or feuhold property (the equivalent of freehold under English law) and leasehold property for a term of more than 20 years. Standard securities follow a statutory form.

FLOATING CHARGES

A floating charge is a charge over all of the assets of a company and, unlike the position in England, the floating charge is a separate legal document in Scotland covering all of the assets of a company that are held at the time of enforcement, subject to the priority of certain fixed charges and of certain other preferred debts (including a ‘prescribed part’ which is made available for unsecured creditors). A floating charge is usually enforced by way of appointment of an administrator.

ASSIGNATIONS IN SECURITY

This is a form of security which can be created over incorporeal moveable assets in Scotland and is the equivalent of an English law assignment. However, because there is no concept of equitable security in Scotland, any assignment in security must be intimated (effectively notified to the counterparty) in order for the security to be treated as valid.

PLEDGES

A pledge is a fixed security over corporeal moveable property. In order to perfect a pledge, the chargee, or its nominee, must have possession of the actual asset. For that reason the only form of pledge which is common to see in Scotland is a pledge over shares. In order to perfect a pledge over shares, the shares in the relevant company must be transferred to the chargee, or its nominee. This is often an issue for banks out with Scotland even though the Companies Act does largely address the various concerns that are raised in relation to this, for example, by making it clear that where shares are only held by way of security, the registered shareholder does not need to treat the relevant company as part of its overall group for various purposes including tax. It should be noted that, in addition to this, the introduction of the person with significant control regime in the UK has led to an (ongoing) debate amongst lawyers in Scotland as to whether a bank which holds shares in a company by way of security should be treated as a person of significant control in relation to that company. The view that the firm takes at present is that this is not the case. However, other firms in the market disagree.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be probative (i.e., admissible in court without further evidence), a guarantee needs to be in writing and signed by the guarantor.

Guarantees and other securities can be signed on a unilateral basis (i.e., unlike the case of English law, there is no requirement under Scots
law that a guarantee should be given for consideration (although see above for other conditions).

Additionally, there is a risk that a guarantee may be set aside if it was procured by undue influence by a borrower or lender. A party being provided with a guarantee should be alive to this issue and take steps to avoid claims of undue influence by, for example, requiring the guarantor to take separate legal advice (note, this is a significant issue if the guarantor is an individual, particularly if they are a spouse of the borrower).

**Giving or taking security**

Some funders take the view that rather than intimate the assignation and security of a contract or write themselves up as registered members pursuant to a share pledge, they will maintain an 'unintimated' or 'unregistered' position up until such a time as they require to enforce the relevant security. This is occasionally seen in the Scottish market although DLA Piper advise against taking this approach as, if the 'intimation' occurs only at the time of enforcement, then there is a greater risk that this may be set aside as someone taking security following the onset of insolvency.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the security and notice being given to third parties. Most charges created by a Scottish company must be registered at Companies House within 21 days of its creation. Failure to register within this time means that the charge will be void against the liquidator, administrator or any creditor of the company and the money secured by the charge becomes immediately payable.

There are no notarization requirements for security documents under Scots law.

Like guarantees, for a period after a new security interest has been granted (known as the hardening period), it is at risk of being set aside in certain circumstances under insolvency laws. Reviewable transactions include those conducted at an undervalue, preferences and invalid floating charges.

*Last modified 20 Oct 2017*

**Financial regulation**

**Law and regulation**

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

Financial Services Act 2012
Financial Services and Markets Act 2000
Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

**Consumer credit**

Consumer Credit Act 1974 (as amended)
FCA Handbook, Consumer Credit sourcebook

**Mortgages**

FCA Handbook
Mortgage Credit Directive (2014/17/EU) (mortgage credit)
Mortgages and Home Finance: Conduct of Business sourcebook

**Corporations**
Companies Act 2006
Overseas Companies Regulations 2009

Funds and platforms


Other key market legislation

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)
Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)
European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives)
Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)

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Regulatory authorization

Who are the regulators?

The Financial Conduct Authority (FCA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets, and also the prudential regulator for many firms. It is also responsible for enforcing the market abuse and listing regimes.

The Prudential Regulation Authority (PRA) is responsible for the prudential regulation of systemically important financial institutions, including banks, building societies, insurers and major investment firms.

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What are the authorization requirements and process?

Depending on the type of firm, a firm must apply to the Financial Conduct Authority (FCA) or Prudential Regulation Authority for authorization.

The regulators must assess whether the application meets the required threshold conditions within six months of the submission of the complete application.

The application fee depends on the type of the application ranging from £1,500 to £25,000.

The regulator will also approve key individuals (eg senior management) in their roles.

Authorized firms and individuals are listed on the FCA Register.

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What are the main ongoing compliance requirements?

Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and loss of regulated status.

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What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment.

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Regulated activities

What finance and investment activities require authorization?

Generally

A person must not carry on a regulated activity in the UK unless authorized or exempt (known as the general prohibition).

A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in the UK and it does not fall within any of the available exemptions.

• Specified activities include activities such as accepting deposits, dealing in, managing, arranging and advising on investments, and establishing collective investment schemes.

• Specified investments include deposits, shares, debt instruments, options, futures, units in a collective investment scheme and government and public securities.

Consumer credit

Consumer credit activities, including credit broking, operating an electronic system in relation to lending and entering into a regulated credit agreement as lender are regulated activities.

Unless exempt agreements, these activities can only be offered by firms who are authorized and listed on the financial services register. The available exemptions relate to the nature of the agreement, the lender and the borrower, the number of repayments to be made and the total charge for credit. For example, credit agreements exceeding £25,000 that are entered into exclusively or predominantly for the purposes of the business of the borrower are exempt agreements.

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Are there any possible exemptions?

There are two types of exclusions available when regulated activities may be undertaken without authorization:

• General exclusions – Certain persons may carry on a regulated activity without being authorized. For example, in certain cases regulated activities carried on by overseas persons may be undertaken without authorization.

• Specific exclusions – For each type of regulated activity there are a number of specific exemptions that could also apply, such as making introductions (that is, making arrangements under which clients can, under certain circumstances, be introduced to another person).

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Do any exchange controls or other restrictions on payments apply?

The UK does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in and out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.
There may also be anti-money laundering and tax considerations to take into account.

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What are the rules around financial promotions?

A financial promotion is a communication of an invitation or inducement to engage in investment activity made by a person in the course of business. Since such communications can influence consumers, a person is restricted from communicating such promotions unless they are an authorized person, or the content of the communication has been approved by an authorized person, or the promotion falls within one of the exemptions.

It is a criminal offence for an unauthorized person to communicate a financial promotion.

Exemptions

Exemptions include certain promotions to certified high-net worth individuals or overseas recipients, provided certain criteria are fulfilled.

Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are limited companies and limited liability partnerships, both of which are body corporates with separate legal personality and limit the liability of their members.

Limited companies can either be private (denoted by the suffix Ltd or Limited) or public (denoted by the suffix PLC or Public Limited Company) depending on whether their shares are offered to the public. Some activities require a particular type of legal entity to be used, such as offering debt securities to the public which can only be done by UK Public Limited Companies.

The liability of a company's shareholders can be limited by shares, in which case they are liable to pay for their shares but not the company's debts, or by guarantee, where they are also liable to pay a certain amount if the company is wound up.

Limited liability partnerships (or LLPs) are similar to limited companies in many ways, with the main differences being that they are:

- formed by partners whose relationship is governed by private agreement rather than having shareholders and directors; and
- taxed like a partnership.

Scottish limited partnerships (SLPs) are also often used in transactions. These differ from limited liability partnerships in that instead of having a number of limited liability partners, a Scottish limited partnership has one general partner who has unlimited liability for the partnership and a number of limited partners (often individuals) who only have limited liability. The limited partners have no right to be involved in the management of the business or to enter into documentation on behalf of the limited partnership, with that right instead being held by the general partner. These partnerships are governed by partnership agreements and differ from the English equivalent limited partnerships in that a Scottish limited partnership has separate legal personality and can enter into agreements in its own name (through the general partner).

Funds

Investment funds tend to take the form of limited partnerships, limited companies (including open-ended investment companies (OEICs)), unit trusts (authorized and unauthorized), UK public companies (including those approved by HMRC as UK investment trusts) and authorized contractual schemes (ACS).

Fund managers on the other hand tend to be set up as limited companies (generally limited by shares) or limited partnerships.
**Is it possible to conduct lending or investment business through a branch or establishment?**

Yes.

A company can conduct lending or investment business in the UK through an establishment (also known as a 'branch') but this does not create a separate legal entity.

Overseas companies having a UK establishment need to comply with the Overseas Companies Regulations 2009 which imposes registration, accounting, disclosure and other requirements. Such requirements do not apply to partnerships or other unincorporated entities with a similar UK presence.

Overseas companies carrying on a trade in the UK through a 'permanent establishment' will be subject to UK corporation tax.

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**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Peer-to-peer funding platforms and marketplace lending**

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

**HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?**

Marketplace lending includes peer-to-peer (P2P)-type structures, often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has
also been appealing to larger pools of available capital, such as private equity and venture capital funds, as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt, this will typically result in the platform being treated as a securitization for the purposes of the European Union Capital Requirements Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features, such as; its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.
Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of the transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

**WHAT IS A CRYPTOocurrency?**

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.
The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

In September 2017 the Financial Conduct Authority issued a statement warning the public that 'ICOs are very high-risk, speculative investments' and outlining the potential risks associated with investing in unregulated parts of the financial sector.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

**Data analysis and cloud computing**

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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**Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?**

**General financial regulatory regime**

The Financial Conduct Authority (FCA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets.

**GENERAL**

A person must not carry on a regulated activity in the UK unless authorized or exempt (known as the general prohibition). A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in the UK and it does not fall within any of the available exemptions. Where FinTech products and/or applications involve financial activity which requires regulatory authorization, the firms providing such products and/or applications must be authorized by the FCA.

**PROJECT INNOVATE**

In October 2014, the FCA launched an initiative known as Project Innovate with a view to encouraging innovation in the interest of consumers. Project Innovate has five initiatives:

- **regulatory sandbox** – providing businesses with access to the real market to test innovative products, services, business models and delivery mechanisms;

- **direct support** – providing a dedicated contact for innovator businesses that are considering an application for authorization or a variation to their permission;

- **advice unit** – providing regulatory feedback to firms developing automated models to deliver lower-cost advice and guidance to consumers;

- **reg tech** – encouraging technologies that may facilitate the delivery of regulatory requirements more efficiently and effectively; and

- **engagement** – providing FCA engagement with a wide variety of businesses in the UK regions and internationally.
REGULATORY DEVELOPMENTS ON INVESTMENT PLATFORMS

In July 2017, the FCA published an Investment Platforms Market Study Terms of Reference, recognizing the increasingly important role of investment platforms in the retail distribution landscape. The market study is to focus on the impact of investment platforms on retail consumers and financial advisors, being platform services which involve arranging, safeguarding, administering investments and distributing retail investment products which are offered to retail clients by more than one product provider and which is neither solely paid for by advisor charges, nor ancillary to the activity of managing investments for the retail client.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

Since April 2014, a subsidiary of the FCA, the Payment Systems Regulator has regulated eight payment systems designated by HM Treasury, namely Bacs, Cheque & Credit, CHAPS, Faster Payment Scheme, LINK, Northern Ireland Cheque Clearing, MasterCard and Visa Europe. All participants in a designated payment system will fall under the remit of the Payment Systems Regulator, including operators that manage or operate the systems, the payment service providers using the system and the infrastructure providers to the payment system. A number of FinTech businesses are offering electronic payment platforms to rival the traditional payment systems; and the introduction of the Payment Services Regulations 2017 recognizes the rise in such business with the aim of creating a more level playing field for payment services providers while addressing the need for enhanced security and customer protection.

The FCA Handbook contains a number of electronic money-related rules, directions and guidance aimed at businesses that are issuing or considering the issuing of electronic money (e-money). E-money is defined as electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person other than the electronic money issuer and include pre-paid cards and electronic pre-paid accounts for use online. Generally, firms issuing e-money must be authorized or registered with the FCA.

PEER-TO-PEER LENDERS

A person carries out a regulated activity (requiring authorization by the FCA) if they facilitate lending and borrowing between two individuals or between individuals and businesses of less than £25,000 in circumstances where the borrower does not enter into the agreement wholly or predominantly for business purposes. Such agreements are known as Article 36H Agreements and will only be caught by the regulations where either the lender or the borrower is an individual or a partnership with two or three persons or an unincorporated body.

Regulation of payment services

Where a UK business provides payment services as a regular occupation or business activity in the UK, it will require authorization by the FCA to become an authorized payment institution under the Payment Services Regulations 2017. Failure to obtain the required authorization is a criminal offence. The regulations implement the European Union Payment Services Directive II.

In order to become authorized by the FCA, a payment services business will need to meet certain criteria, including in relation to its business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

Application of data protection and consumer laws

The UK’s Data Protection Act 1998 (DPA) regulates the processing of personal data within the UK. The DPA implements the European Data Protection Directive. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the DPA and have certain notification and compliance obligations.

The European General Data Protection Regulation (GDPR) is due to replace the DPA from 25 May 2018. The GDPR is more prescriptive and restrictive, compared to the principles-based DPA, including mandatory notifications where a breach occurs and provide for severe monetary sanctions for breach.

The UK’s Privacy and Electronic Communications Regulations 2003 (PECR) regulate unsolicited direct marketing by electronic means, in addition to sector specific regulations, such as the FCA’s financial promotions regime.

Money laundering regulations
The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 give the FCA responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment. These regulations implement the European Union's Fourth Money Laundering Directive.

Generally, where a firm is authorized and supervised by the FCA it will also be authorized and supervised by the FCA for complying with anti-money laundering requirements. Electronic currencies such as bitcoin and other cryptocurrencies tend to represent a higher money-laundering risk.

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**What type of funding arrangements and incentives are available to FinTech businesses?**

**Early stage**

**SEED INVESTMENT**

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals, (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

**CROWDFUNDING**

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdcube or Crowdfunder.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

**ACCELERATORS**

There are various incubators or accelerators in the UK market, which offer support, facilities and funding for startups, often in return for an equity stake. For example, Barclays has an accelerator program which offers up to US$120,000 investment from Techstars, together with mentoring from industry experts.

**Venture capital and debt**

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund, examples of which include Santander InnoVentures and Citigroup’s Citi Ventures. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

**Warehouse and platform funding**
Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

One example of warehouse financing involves LendInvest, which borrowed £40 million from Macquarie in 2016 under a warehouse facility, secured against UK mortgage loans. Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, such as Zopa and Funding Circle, which bring individual borrowers and lenders together without the involvement of traditional banks. In 2015, £2.8 billion was originated through P2P platforms in the UK. P2P lending does not involve equity investments; interest is paid on the money borrowed instead.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

The UK has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) is a popular funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the London Stock Exchange. For example, in 2015, Worldpay (a payment processing business) listed on the London Stock Exchange (LSE) in a deal that represented the largest UK IPO of that year. The London Stock Exchange’s Alternative Investment Market (AIM) caters specifically for small, growth-orientated companies and, recently, FreeAgent, (a provider of cloud-based accounting software) raised £10.7 million in its AIM IPO in 2016, having previously raised growth capital through equity crowdfunding.

A number of marketplace loan securitizations have been launched in the UK, where loans originated via marketplace lending platforms are packaged together and sold to investors as bonds. For example, in 2015, Funding Circle completed a £129 million securitization of loans to small and medium sized enterprises (SMEs) that had been originated through its online marketplace lending platform. Later on that year, Zopa completed a £150 million securitization of consumer loans originated on its platform.

FinTech companies have also started to access funding by issuing bonds to retail investors as a way of raising more competitive funding. For example, in July 2017 LendInvest issued an initial £50 million of retail bonds, which are tradeable on the LSE.

**CONVERTIBLE BONDS/LOAN NOTES**

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes, which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

**Incentives and reliefs**

The Seed Enterprise Investment Scheme (SEIS) is designed to help small, early-stage companies raise equity finance by offering 50% income tax relief for individuals who invest in the shares of qualifying startups, up to a maximum investment of £100,000 per annum. This scheme complements the Enterprise Investment Scheme (EIS), which offers a lower rate of income tax relief of 30% to investors in higher-risk small companies. It is worth noting that some financial activities, such as money lending or insurance are non-qualifying trading activities, and as such, EIS and SEIS may not be available for all FinTech companies.

In addition, research and development (R&D) tax credits are an incentive designed to encourage companies to invest in R&D. SME businesses (those with fewer than 500 employees, and either revenue less than €100 million or balance sheet assets less than €86 million) can benefit from up to 230% tax relief on their R&D expenditure.
The Patent Box Scheme enables companies to apply lower rate of Corporation Tax (10%) to profits earned from its patented inventions.

Finally, since 6 April 2017, payments of interest made by a UK borrower to a UK lender through a UK peer-to-peer platform are exempt from withholding tax provided that certain conditions are met. To avail the exemption, the credit provided by the lender to the borrowers needs to have been provided at the invitation of a regulated operator of an electronic system.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

- **Assignation** – An assignation is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignation can be done without the consent of the debtor. An assignation must be notified ('intimated') to the debtor to become effective.

- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

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What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;

- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;

- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;

- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and

- **consent** – whether a transfer requires the consent or notification of any other parties.

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Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in the UK varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

Key sectors are considered below.

Energy

The gas and electricity industries in the UK are privatized, with the generation, transmission, distribution and supply services provided by a number of private sector companies. The relevant private sector companies own the generation, transmission and distribution assets. Notably, the National Grid, a listed public company (albeit heavily regulated) operates all of the mainland transmission lines (although in Scotland these are owned by other entities). On certain offshore projects, private entities other than the National Grid may own transmission lines.

The private sector finances and delivers most of the required infrastructure but there are a number of government policy mechanisms (adopted through legislation) which are used to incentivize investment in eligible energy generation technologies. In certain instances, including on major energy infrastructure, projects may be procured by the public sector and depending on the terms of the procurement, the asset may either be publicly or privately owned.

The Office of Gas and Electricity Markets (Ofgem) (as governed by the Gas and Electricity Markets Authority) is the principal body with responsibility for regulation of the energy sector in Great Britain. There is a separate regulator (the Utility Regulator) for the energy sector in Northern Ireland.

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in the UK are privately owned by a number of service providers. A good example is BT Openreach which is responsible for most of the UK’s broadband infrastructure but whose work is heavily regulated by government; it, in turn, works with more than 500 service providers to provide local access to users.

The Office of Communications (Ofcom) is the regulator of the UK’s telecommunications sector. It also has responsibilities for television broadcast services and wireless communications services.

Transport infrastructure

Light rail

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies. Certain elements of light rail projects may be outsourced to the private sector; for example, the private sector may provide new trams, run a concession or operate and maintain a light rail system on behalf of a local transport executive – the assets will continue, however, to be owned by the public sector.

Heavy rail

The rail market in the UK is privatized but its composition (which is complex) involves both public and private entities. The principal elements to the rail sector in Great Britain are:

- Network Rail, a private limited company, is on the public sector balance sheet and owns, operates and maintains rail tracks, signaling
and station infrastructure. It is responsible for improving most of the regulated national rail infrastructure for operating some of the stations on the national rail network.

- Public transport authorities, ie central and devolved government bodies and some metropolitan bodies, specify, let and manage operating contracts and give Network Rail a significant proportion of the funding for infrastructure maintenance and enhancement.

- Train Operating Companies (TOCs) are awarded franchises by the Department for Transport or local transport executives to operate certain train lines. ‘Open Access TOCs’ may apply to the rail regulator for use of certain train paths/routes when not being used by the franchised TOCs. The Scottish TOC is currently Scotrail, a subsidiary of Abellio. Scotrail and Network Rail in Scotland, although separate entities, have a common management structure.

- Freight Operating Companies (FOCs) are wholly commercial entities.

- Rolling Stock Companies (ROSCOs) are private entities which own and maintain rolling stock and lease them to the TOCs for use on their franchise.

- Project finance: There has been one deal (both phases of the Intercity Express Programme) where rolling stock has been procured through a project finance model and on that deal it is the private sector which owns the trains and will continue to do so following the expiry of the main contract with the public sector.

The rail sector is regulated by the Office of Rail and Road (ORR).

ROADS, BRIDGES AND TUNNELS

Transport Scotland, an executive agency of the Scottish Government accountable to the Scottish Ministers, are responsible for the trunk road network in Scotland.

AVIATION

Aviation in the UK is (for the most part) privatized. As regards airport infrastructure, there are a number of ownership structures in the UK market, including private ownership, local government ownership and various forms of public-private ownership. All models are heavily regulated by government and the Civil Aviation Authority is the aviation regulator in the UK.

PORTS

The UK ports sector comprises a variety of company, trust and municipal ports, all operating on commercial principles, independently of government and largely without public subsidy. The private sector operates the vast majority of the UK’s major ports.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES CENTERS/PRISONS)

Typically, these are owned by the public sector with the exception of social housing projects (please see below) with the private sector's responsibility being for any or all of the design, build, financing, operation and maintenance of the infrastructure. The majority of social infrastructure assets in the UK are directly financed by the government. Subject to value for money considerations, private finance may also be used in the procurement of social infrastructure assets – namely, using the Private Finance Initiative (in the past) and its successors in Scotland, the Non-Profit Distributing (NPD) Model.

Education

The ownership of a school's infrastructure is generally by the relevant local authority. For example, in the case of a local authority maintained school, the school and playing fields will be owned by the local authority; and an academy school (which receives funding directly from the government) may lease land from a local authority. The current program for new schools is through the ‘Priority Schools Building Programme’, delivering schools either through a traditional construction procurement or on a project-financed basis albeit there is an unusual ‘Aggregator’ structure for that latter.

Hospitals

Ownership of hospitals is vested in various public sector bodies operating within the National Health Service in Scotland.

Social housing
This is a diverse sector involving many different organizations and individuals including housing developers, building contractors, mortgage lenders, local authorities, housing associations, landlords, owner-occupiers, private renters and those in the social rented sector. Typically, on a social housing project, housing associations own the relevant housing stock. Although housing associations tend to be private limited companies their governance is constrained by public sector regulation and, effectively, operate as quasi-public sector entities.

DEFENSE

Typically, defense assets are owned by the public sector.

WASTE

In the past, the public sector procured new waste treatment or collection facilities and these were owned by the public sector even if the private sector would be responsible for design, build, operation or maintenance of the facility. One example being long-term Private Finance Initiative (PFI) contracts with private sector companies in relation to the building and operation of waste infrastructure, with financial support being provided to the local authorities by the government through the PFI in respect of the cost of those projects. Increasingly, merchant facilities, namely those developed and operated by private sector entities, are being used and these facilities serve both their public sector and private sector customers.

WATER

In Scotland, water and wastewater services are provided by a state-owned company (Scottish Water). The Water Industry Commission for Scotland (WICS) is the relevant regulatory body.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in the UK over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission [or a development consent order]; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body (eg a government department, a local authority or a National Health Service Trust) is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval. Key sector-specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on ‘Change of Control’. This is less of a concern on private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy markets in the UK have a complex system of arrangements between suppliers, generators, transmission and distribution which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customer and the National Grid and these are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.
Telecoms infrastructure

There is a complex regulatory environment for this sector including how access and interconnectors (between networks) are regulated under the Communications Act 2003 and (Access to Infrastructure) Regulations 2016 and how Ofcom grants rights to access private or public land in order to install and maintain essential equipment in, over or under that land. This equipment might be cables sunk beneath the ground or a mobile mast sited on the ground.

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

Transport infrastructure

RAIL

There is an extensive and complex regulatory framework to consider in respect of a practical and operational involvement in this sector. Key areas include understanding the regulatory regime for certification for train use and acceptance and user fare regulation. Depending on how an investor wishes to invest in a project (specifically what type of entity or asset), there is a varying degree of difficulty for investors to enter into an existing project. For example, rolling stock operating companies (ROSCOs) are privately owned companies where third party investment is relatively common whereas train operating companies (TOCs) are often special purpose vehicles so, in theory, investment into a TOC should be relatively straightforward. However, any change in control of a TOC under a Franchise Agreement will usually require a consent from the Department for Transport.

ROADS

In order for a private sector partner to carry out its duties on certain types of roads projects, the procuring public sector authority (Transport Scotland or a local authority) may delegate certain of its statutory duties to the private sector partner. This will be dependent on the project and the specific contractual requirements. Any investor will, therefore, need to understand those duties and whether it is able to subcontract those duties to an appropriate person. There is usually a restriction on the change of control of the private sector partner during the construction period. Following the construction period, the private sector may be allowed a change of control provided that they do not fall within a definition of an 'Unsuitable Third Party' (which may include concerns about national security, tax avoidance). The precise scope of the restrictions will depend on the contractual terms.

Other infrastructure

On publicly-procured infrastructure, it is quite common for long-term projects to have a 'change in control' clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the construction period but this is often relaxed post construction provided any change in control is not to an 'Unsuitable Third Party'. How strict these restrictions are will often depend on the sector. For example, the defense sector usually gives the Ministry of Defence a strong degree of discretion (particularly on the grounds of national security) as to whether to accept a change in control over its private sector partner.

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What is the applicable procurement process?

Public procurement in Scotland is, for the time being, in most instances governed by the Public Contracts Regulations 2015 which is based on EU Directives. There are some sector-specific regulations such as the Utilities Contract Regulations 2016 (applicable to the rail sector, water and energy) and the and Security Public Contracts Regulations 2011 (these are also based on EU Directives and therefore subject to change as the UK leaves the EU).

The key principles are that contract procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

Investing in energy and infrastructure

Public procurement is relevant where the UK government, or a branch of it, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant
procurement legislation applies to certain public bodies including central government departments, local authorities, police and fire authorities, NHS Trusts, various non-governmental bodies such as the Competition and Markets Authority and the House of Commons. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.

- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer’s bid.

- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

**Financing energy and infrastructure**

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector.

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**What are the most common forms of funding / investing in energy and infrastructure?**

The principal forms of private sector funding/investment in energy and infrastructure in the UK (including in relation to public-private partnerships) are as follows.

**Funding**

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders. (For publicly procured project financed deals in Scotland, this often means using the NPD model which is a successor to the Private Finance Initiative (PFI));
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing; this is particularly relevant in the rail sector.
Following the global financial crisis, the UK government has tried to expand the funding base and increase liquidity in the market (particularly encouraging institutional investors) by various means. These include HM Treasury/Infrastructure UK offering the UK Guarantee Scheme to guarantee certain types of debt on an infrastructure projects (for example, guaranteeing bond finance debt (similar to the role monolines used to play on such deals) so as to lower debt pricing to near gilt levels) and the Green Investment Bank lending on energy projects (although the latter is in the process of being privatized).

Funding/funding products can also, sometimes, provided by the European Investment Bank and export credit agencies.

Investing

Common forms of investing in energy and infrastructure include:

- ‘equity’ investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of 'equity').

Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Financial Conduct Authority or the Prudential Regulatory Authority considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

What regulatory penalties may apply?

When a rule breach has taken place, the Financial Conduct Authority or the Prudential Regulatory Authority may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

What criminal penalties may apply?

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the Money Laundering Regulations; and
- conducting regulated activities when not authorized.

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?
Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

**ADVANCE OF LOAN**

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

**TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN**

A written instrument transferring or assigning a debt under a loan is, in principle, chargeable to 0.5% UK stamp duty. An agreement to transfer a debt is also, in principle, chargeable to UK stamp duty reserve tax (SDRT) (although, in practice, a payment of both UK stamp duty and SDRT should not be required). However, provided the debt constitutes loan capital and does not have certain offensive features (such as a right to interest exceeding a commercial return or a right to conversion into shares or other securities), the written instrument assigning or transferring, or the agreement to assign or transfer, such debt should be exempt from both UK stamp duty and SDRT. This is known as the loan capital exemption.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There is no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security.

However, most security interests created by English companies and English limited liability partnerships must be registered at Companies House to perfect the security and ensure it is valid against third parties. The grant of most security interests over UK real estate should also be registered at the Land Registry (in the case of real estate in England and Wales) and the Scottish Land Registry (in the case of real estate in Scotland) to ensure that the security interest takes effect as a legal charge. It would be unusual for the fees payable for such registrations to be a material amount.

Other forms of registration may also be required (or be advisable), depending on the nature of the asset over which security is taken. Such registrations may also require the payment of fees.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

**ISSUE OF DEBT SECURITIES**

*Bearer bonds*

The issue of a debt security in the UK which is a bearer bond or the issue by or on behalf of a UK company of a debt security which is a bearer bond, in principle, gives rise to a charge to UK bearer instrument duty (BID). Such BID is chargeable at a rate of 1.5% of the issue price of the bearer bond. However, currently, HM Revenue and Customs is not seeking to collect BID on the issue of a debt security which is a bearer bond.

*Registered bonds*

Subject to the special regime for issues into a depository or clearing system (see below), there is generally, no charge to UK stamp duty or SDRT on the issue of a debt security which is a registered bond. The issue of a debt security which is a registered bond should also not give rise to a charge to BID (which is only relevant to bearer instruments).

**TRANSFER OF BONDS**

*Bearer bonds*

The first transfer in the UK of a debt security which is a bearer bond issued outside of the UK by a non-UK company, in principle, gives rise to a UK bearer instrument duty charge (if stamp duty would have been payable on the instrument of transfer if the bond had been in registered form). Such BID is charged at a rate of 1.5% of the transfer consideration. UK stamp duty only applies in respect of written
instruments of transfer and so is not, normally, relevant to the transfer of a debt security which is a bearer bond, provided it is transferred by delivery. However, any agreement to transfer a bearer bond issued by or on behalf of a UK company is, in principle, chargeable to SDRT. Such SDRT is charged at a rate of 0.5% of the transfer consideration.

Registered bonds

A written instrument transferring a debt security which is a registered bond is, in principle, chargeable to UK stamp duty if the instrument is executed in the UK, or relates to UK stock or marketable securities or to something done, or to be done, in the UK. Any agreement to transfer a debt security which is a registered bond issued by a UK company or registered in a UK register is also, in principle, chargeable to SDRT. Such UK stamp duty and SDRT are chargeable at a rate of 0.5% of the transfer consideration.

DEPOSITARY AND CLEARING SYSTEMS

Bearer bonds and registered bonds

A written instrument transferring certain debt securities to a person whose business is, or includes, issuing depositary receipts or the provision of clearance services for chargeable securities (or the agent or nominee of such a person) is, in principle, chargeable to UK stamp duty. Such stamp duty is generally chargeable at a rate of 1.5% of the consideration or market value of the debt securities (depending on the circumstances).

The issue or transfer of certain debt securities to a depositary receipt issuer (or its nominee), where a depositary receipt is issued or to be issued, or the issue or transfer of debt securities into a clearing system (or its nominee) in pursuance of an arrangement for the provision of clearance services, in principle, gives rise to a charge to SDRT. Such SDRT is generally chargeable at a rate of 1.5% of the issue price, consideration or market value of the debt securities (depending on the circumstances). However, currently, HM Revenue and Customs is not seeking to collect SDRT on the issue, or (where integral to the raising of capital) the transfer, of debt securities into a clearing system or depositary receipt system, provided that the debt securities comprise loans raised by the issue of debentures or other negotiable securities for the purposes of Article 5(2)(b) of the Capital Duty Directive (2008/7/EC).

EXEMPTIONS

While in some circumstances, both UK stamp duty and SDRT may apply to the same transaction, as a general principle, there should be no double charge due to the operation of a franking system.

If a debt security benefits from the loan capital exemption, the issue or transfer of such debt security (whether a bearer bond or registered bond) should not be chargeable to UK stamp duty, BID or SDRT. The loan capital exemption applies to loan capital that does not have certain offensive features (such as a right to interest exceeding a commercial return or a right to conversion into share or other securities). The loan capital exemption is therefore the key exemption in the context of capital markets transactions and serves to exempt most vanilla bonds entirely from UK stamp taxes.

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Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over HM Revenue and Customs on enforcement of security.

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Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Unless an exemption applies, where a payment of interest with a UK source is paid under a loan which is intended or expected to have a duration of a year or more, an amount equal to the basic rate of the interest payment is required to be withheld and paid to HM Revenue and Customs.
**If so:**

*What is the rate of withholding?*

The current rate of UK withholding tax (i.e., the basic rate) is 20%.

**What are the key exemptions?**

The most commonly relied on exemptions to ensure that interest payments made by UK companies can be made free of UK withholding tax include:

- The exemption for interest paid on an advance from a UK tax resident bank;
- The UK-to-UK exemption (applicable where interest is paid to a lender which is a UK tax resident company or a partnership of such companies);
- The quoted Eurobond exemption (applicable to interest paid on a security which is listed on a recognized stock exchange);
- Reliance on a double tax treaty (such treaty may only provide for partial exemption);
- The qualifying private placement (the key requirement being the residence of the lender in a qualifying double tax treaty jurisdiction); or
- Reliance on the EU Interest and Royalties Directive as implemented by UK law (the key requirement being that the lender and the borrower meet the association requirement).

**Would the same analysis apply to interest payments under a debt security (e.g., a bond)?**

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security. The quoted Eurobond exemption is particularly relevant to debt securities.

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**Are foreign lenders and debt security holders subject to tax on interest payments?**

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g., by virtue of incorporation, residence or local branch)?

No.

**Would the same analysis apply to interest payments under a debt security (e.g., a bond)?**

Yes.

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**Key contacts**

**Sarah Day**

Partner
DLA Piper UK LLP
sarah.day@dlapiper.com
T: +44 (0)113 369 2104
United Arab Emirates

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are a number of restrictions on offering and selling debt securities under UAE law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities (including foreign debt securities) to the public in the UAE or to provide trading services in respect of those debt securities without an appropriate license or approval from the Securities and Commodities Authority (SCA).

The SCA has published detailed rules and guidance on the restrictions for offers of debt securities in the UAE. These restrictions are aimed at preventing a breach of the rules on financial promotion and the protection of retail customer. However, the SCA’s rules and regulations are still evolving and there continue to be changes in respect of permitted exceptions and exclusions to the SCA’s regime.

Acting as a principal in respect of financial products that affect the financial position of any of the licensed financial institutions, including (but not limited to) debt securities will also be considered financial activities subject to UAE Central Bank licensing and supervision in accordance with the provisions of the New Banking Law.

What are common issuing methods and types of debt securities?

The most common types of debt securities issued in the UAE are bonds, Sukuk (also known as Islamic bonds) or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in the UAE. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities and floating-rate securities;
- Islamic debt securities (Sukuk) characterized by the type of underlying Islamic structure or payment profile such as fixed-rate Islamic securities and floating-rate Islamic securities;
- guaranteed securities, subordinated securities, securities issued for regulatory capital purposes (Tier 1 or Tier 2);
- asset-backed securities; and
- convertible or exchangeable bonds.
**What are the differences between offering debt securities to institutional/professional or other investors?**

In summary, the promotion of debt securities or trading service to any person in the UAE requires a Securities and Commodities Authority (SCA) license or approval. The SCA does, however, make certain exclusions from this requirement:

- There is a distinction between institutional 'Qualified Investors' and other investors for the purposes of offering and selling debt securities under UAE law, and promoting to (or introducing) institutional investors and licensed financial institutions, or government bodies (and entities owned by them) is permitted.

- Acting on the basis of a reverse solicitation may also be permitted in certain circumstances.

However, promoting or introducing in relation to UAE retail or high net worth individuals is not permitted without the relevant license or approval (which may involved a locally authorised firm).

If in any doubt as to the scope or application of an exemption, we would always recommend contacting the SCA directly to clarify the latest position in this regard.

_Last modified 23 Jan 2020_

**When is it necessary to prepare a prospectus?**

The general position under UAE law is that a prospectus is required where there is either:

- an offer to the public of the relevant debt securities; or

- an application is made for listing on one of the exchanges in the UAE.

However, on the basis that debt securities are often also marketed outside of the UAE, the local debt securities market has seen a degree of alignment with prospectus requirements under the EU Prospectus Directive.

_Last modified 23 Jan 2020_

**What are the main exchanges available?**

In the UAE, there are three main exchanges:

- **Dubai Financial Market (DFM)**
  
  DFM was created in 2000 and operates as a secondary market for the trading of securities issued by public shareholding companies, bonds issued by federal or local governments, local public institutions and mutual funds as well as other local or foreign DFM approved financial instruments. DFM is governed and regulated by the Securities and Commodities Authority (SCA). In 2010, DFM consolidated its operations with NASDAQ Dubai, which means investors can trade across the two exchanges. However, both exchanges are regulated separately, DFM by the SCA and NASDAQ Dubai by the Dubai Financial Services Authority (DFSA).

- **Abu Dhabi Securities Exchange (ADX)**
  
  ADX was also established in 2000 and operates as a secondary market for the trading of different types of securities. It currently has trading locations in Al Ain and in the Emirates of Fujairah, Sharjah and Ras Al-Khaimah. ADX is governed and regulated by the SCA.

- **NASDAQ Dubai**
  
  NASDAQ Dubai was created in 2005 and is based in the Dubai International Finance Centre (DIFC) which has an independent commercial legal system based largely on English law. The exchange is regulated by the DFSA. There is also a greater emphasis on a regional (and global) role for NASDAQ Dubai by contrast to the domestic focus of DFM and ADX.

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Is there a private placement market?

The UAE has a relatively active private placement market.

There is no dominant standard for documentation, but private placement documentation will often take into consideration the style/approach of the Loan Market Association and International Capital Markets Association (if appropriate to do so).

Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers, originators and obligors are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under UAE law.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee (or delegate), which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

In certain respects, the legal and regulatory framework in the UAE is still developing for debt securities (and is therefore viewed as an emerging market). Accordingly, there may be certain additional risks for investors in terms of enforceability of obligations and the ability to exercise certain rights. However, this will ultimately depend of the nature of the debt securities and careful consideration will need to be made as to the appropriate risk factors to be included in the prospectus or offering document in this regard.

Before making an investment decision, prospective investors in debt securities should always consider carefully – in the light of their own financial circumstances and investment objectives – all of the information in the prospectus (and consult their own financial, tax, legal and other professional advisors regarding the suitability of any debt security).

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Onshore UAE

The federal securities regulatory authority of the UAE is the Emirates Securities and Commodities Authority (SCA), which is responsible for regulating the rules applicable to the incorporation and establishment of domestic funds as well as the promotion and marketing of foreign funds, in the UAE.

Generally speaking, under the relevant regulations (notably SCA Board Decision No.3 of 2017 regarding the Promotion and Introduction Regulations (PIRs)), the promotion of financial products to persons in the UAE requires a SCA license for which an onshore UAE business presence is required. Any person introducing UAE investors to a service provider in order to receive financial services, including trading services, needs to get the SCA's approval. However, neither the SCA license nor the SCA approval requirements apply when an exclusion is available. For example, promoting to, or introducing, institutional investors and licensed financial institutions, or government bodies and entities owned by them are excluded as is acting on the basis of a reverse solicitation. Promoting or introducing in relation to UAE retail or high net worth individuals is not permitted without the relevant license/approval. Finally, while licensed promoters need only notify the
SCA of any promotions they make in the UAE, promoters proposing to market foreign funds in the UAE must obtain the SCA's prior approval.

These requirements also apply to firms located in the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global market (ADGM) when they wish to approach retail or high net worth individuals who are located in the UAE.

**DIFC**

In the DIFC, the Dubai Financial Services Authority (DFSA) is the relevant regulatory authority that oversees funds established and marketed in the DIFC. Similarly with the position onshore in the UAE, various licencing requirements must be met before a fund can be established and promoted in the DIFC. For example, depending on the type of fund there may be requirements to register the fund with the DFSA or notify the DFSA of the fund's activity, as well as certain licencing requirements that fund managers operating in the DIFC must meet.

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**What are common fund structures?**

**Onshore UAE**

The SCA Chairman Decision No. 9 of 2016 Concerning the Regulations as to Investment Funds (Investment Fund Regulations) governs the establishment, licensing and management of funds in onshore UAE. The types of funds that are able to be established under the Investment Fund Regulations include:

- public investment funds (i.e. funds which target any type of investor); and
- private investment funds (i.e. funds which target only qualified investors).

The Investment Fund Regulations provide that these public or private funds may either be "open-ended" (i.e. a fund with variable capital where the number of unitholders can increase or decrease) or "close-ended" (i.e. a fund with generally fixed capital). Under the Investment Fund Regulations:

- all funds established have corporate personality and independent financial liability; and
- all funds must be managed by a management company that is licensed in accordance with the Investment Fund Regulations, meets certain minimum capital requirements and meets other operational requirements set out in the Investment Fund Regulations.

**Dubai International Finance Centre (DIFC)**

The three types of corporate entity that can be used to establish a domestic fund in the DIFC are:

- investment companies;
- investment trusts; and
- investment partnerships.

Trust structures are predominately used for property funds and investment partnerships are commonly used for private equity funds. An investment partnership is a limited partnership registered with the DIFC, comprised of general partners and limited partners. The general partner must be authorized by the Dubai Financial Services Authority (DFSA) to act as the fund manager.

The three types of fund that can be established in the DIFC are:

- public funds (including REITs);
- exempt funds; and
• qualified investor funds (QIFs).

As public funds are open to retail investors, more extensive regulatory requirements apply to these funds. Exempt funds are only open to professional clients who must make a minimum subscription of US$50,000, and cannot be offered to the public (distribution is only allowed through private placement). Private equity funds are usually exempt funds.

A QIF provides a lower cost and less regulated alternative to an exempt fund. The QIF regime is specifically targeted at sophisticated investors such as high net worth individuals and family offices. To qualify as a QIF, the fund must meet all of the following criteria (both at inception and on an ongoing basis):

• units in the QIF must only be offered by way of private placement to unit holders who meet the ‘professional client’ criteria; and

• unit holders must subscribe for at least US$500,000 of units in the QIF.

The DIFC has also adopted a special purpose company (SPC) structure through which many managers effect their private equity, real estate and alternative investments. Managers have looked to the SPC structure due to the short time frame to establish an SPC (i.e. one week versus potentially months to establish in other local jurisdictions), as well as the DIFC’s legal regime (which is based on English law) and the general recognition and treatment of DIFC companies as onshore companies for tax and regulatory purposes in the GCC.

What are the differences between offering fund securities to professional / institutional or other investors?

Onshore UAE

When it comes to offering or marketing securities in onshore registered funds, the main rule is that fund securities may not be offered if such funds securities have not been approved and registered with the SCA. Very limited exceptions however may apply in the context of a private offering made to Qualified Investors (noting that the Qualified Investors exception does not apply to natural persons whether or not such natural persons are high-net worth individuals).

DIFC

In relation to offering or marketing securities in DIFC registered funds, the governing regulations (i.e. the Collective Investment Law DIFC Law No. 2 of 2010 (Collective Investment Law)) provides that, for offering securities to both professional/institutional investors (known as “Professional Clients”) and for offering securities to other investors (such as retail investors), a prospectus must be prepared and the offer must be made by a qualified fund manager. However where the regulations differ between professional/institutional investors and retail investors is when it comes to publication of the prospectus, given that the Collective Investment Law provides that where an offer of securities is in relation to a “Public Fund” (i.e. any fund which includes retail investors) then the prospectus must be filed with the with the relevant DIFC authority.

General comments

Care should be had when marketing an onshore registered fund in an offshore jurisdiction and vice versa, given that the relevant regulatory authorities may have memorandums of understanding in place which set out separate regulations with respect to these situations. We also note that the fund regulations, both onshore and offshore, are subject to any guidance notes issued by the respective authorities that may be published from time to time.

Are there any other notable risks or issues around establishing and investing in funds?

In certain respects, the legal and regulatory framework in the UAE (both onshore UAE and the Dubai International Financial Centre (DIFC)) is still developing for the funds market (and is therefore viewed as an emerging market). Accordingly, there may be certain additional risks...
for investors in terms of enforceability of obligations and/or the ability to exercise certain rights. However, this will ultimately depend on the nature of the fund and careful consideration will need to be made as to the appropriate risk factors to be included in the prospectus or offering document in this regard.

Before making an investment decision, prospective investors in funds should always consider carefully – in the light of their own financial circumstances and investment objectives – all of the information in the prospectus (and consult their own financial, tax, legal and other professional advisors regarding the suitability of any debt security).

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Onshore UAE

Funds promoted and introduced to investors based onshore in the UAE will need to be registered with the UAE Securities and Commission Authority (SCA) unless a statutory exemption applies (noting that the regulations provide for exemptions for reverse solicitation and for marketing to "Qualified Investors", among others). For an issuer to be able to obtain a licence to promote funds to investors in the UAE, the issuer must:

• seek approval of the SCA;
• meet certain minimum capital requirements;
• pay applicable licence fees; and
• undertake to comply with the relevant SCA rules and conditions.

Once the fund is registered then, in order to market securities/units in the fund, the issuer will be required to comply with various rules regarding prospectuses, documentation regarding key investor information and ensuring that the fund has an investment policy.

DIFC

In the Dubai International Financial Centre (DIFC), "Public Funds" are required to be registered with the Dubai Financial Services Authority (DFSA). An application to register a Public Fund must include, among other things, the fund’s constitution and prospectus. Other funds established in the DIFC such as "Exempt Funds" and "Qualified Investor Funds" are not required to be registered with the DFSA, however the DFSA must be notified prior to any offering of securities/units with respect to such funds.

When it comes to offering securities/units, the governing regulations (i.e. the Collective Investment Law DIFC Law No. 2 of 2010 (Collective Investment Law)) provide that before any offer a prospectus must be prepared by a qualified fund manager which, for Public Funds, is to be registered with the DFSA.

Are there any restrictions on managing a fund?

Onshore UAE

All entities that practice the activities of establishing and running onshore funds must be licenced with the UAE Securities and Commission Authority (SCA). In order to obtain a licence then the management entity must meet the criteria specified in the SCA Chairman Decision No. 9 of 2016 Concerning the Regulations as to Investment Funds (Investment Fund Regulations), which includes:

• being a company operating in the area of securities / fund management, or being a local or foreign bank specified in the Investment Fund Regulations;
• meeting certain minimum capital requirements;
having its Memorandum of Association authenticated;

- paying the prescribed licencing fees;
- appointing personnel with the necessary technical and administrative expertise; and
- meeting certain other operational requirements.

**DIFC**

Hedge funds in the Dubai International Financial Centre (DIFC) are regulated by the Collective Investment Rules module of the Dubai Financial Services Authority (DFSA) Rulebook, similar to other investment funds. The DFSA has implemented the Hedge Fund Code of Practice (Code), which sets out the principal risks associated with hedge funds and similar structures and sets out best practice standards. Hedge fund managers are permitted a degree of flexibility to adapt the standards to suit their particular businesses in light of market conditions and emerging issues. These standards, *inter alia*, address back-office systems, valuation procedures, and the skills and resources of the manager.

The Code, which sets out best practice standards for Fund Managers of Hedge Funds in the DIFC (i.e., Fund Managers of Public Funds, Exempt Funds or qualified investment funds (QIFs) which are classified as Hedge Funds), addresses risks inherent in the operation of Hedge Funds and are set out under the following nine principles:

- **principle 1** – appropriate skills and resources to conduct the operations of the fund;
- **principle 2** – robust and flexible investment process in line with the risk profile of the fund;
- **principle 3** – systems and controls to mitigate trading related risks;
- **principle 4** – adequate back-office systems and controls;
- **principle 5** – appropriate measures to identify and manage portfolio risks;
- **principle 6** – adequate valuation policies and procedures;
- **principle 7** – no arrangements where material benefits are given only to some investors;
- **principle 8** – adequate systems and controls to deal with market sensitive information; and
- **principle 9** – no investment in underlying hedge funds without appropriate due diligence.

**Entering into derivatives contracts**

*Are there any restrictions on entering into derivatives contracts?*

The development of derivatives in the UAE has not been without its challenges for a number of years due to the lack of recognition of close-out netting and the absence of a UAE law dealing with derivatives contracts. This is no longer the case with the recent introduction of Federal Law No. 10 of 2018 (the “Netting Law”) which applies to counterparties based 'onshore' in the UAE.

Before the Netting Law, financiers would effectively be taking their chances with the UAE Federal Bankruptcy Law - which only allows set-off or netting of debts that are contractually agreed before the onset of insolvency. This left a great deal of uncertainty as to the enforceability of netting provisions in any post-insolvency scenario involving a UAE counterparty.

The new Netting Law is expected to provide greater certainty by recognising the principle of close-out netting as incorporated into a master level agreement (intended to cover a series of derivatives transactions between two parties), by providing for a single 'net' amount to be payable - as between those parties - upon a close-out or termination. Furthermore, qualified financial contracts under the umbrella of a master agreement constitute a 'single' agreement which is essential for the purposes of netting multiple financial contracts entered into between the same two counterparties.

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What are common types of derivatives?

Although a variety of derivatives structures exist in the UAE, so far, the only relevant court decisions relate to foreign exchange contracts.

The new Netting Law contemplates a number of qualified financial contracts as well Shariah compliant contracts: murabaha, musawamah, master collateralized murabaha, restricted and unrestricted wakala, alternative profit rate swap, alternative cross-currency swap and alternative foreign exchange forward are all mentioned.

Are there any other notable risks or issues around entering into derivatives contracts?

UAE courts are in general not very experienced in dealing with complex financial transaction structures, and will often require an expert to be appointed to guide the court on such matters. The Netting Law is relatively new and remains largely untested with very few case law dealing with derivatives transactions. Accordingly, the parameters around its implementation remain to be seen.

The ISDA has commissioned a law firm to provide a netting-law opinion in respect of the enforceability in the UAE of the ISDA Master Agreement.

Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

LICENSING REQUIREMENTS IN THE UAE

The Central Bank of the UAE (Central Bank) and the Securities and Commodities Authority (SCA) are the main regulatory bodies for financial services in the UAE (except in the DIFC and ADGM). Pursuant to Federal Law No. 14 of 2018 (New Banking Law), the Central Bank regulates financial institutions, including those who wish to provide financing in or from onshore UAE.

Lenders including commercial banks, investment banks, investment companies, finance companies, Islamic banks, Islamic finance companies and real estate finance companies are regulated by the Central Bank and require a license.

In order to obtain a license from the Central Bank to carry out one or more licensed financial activities, a letter of application, certain corporate documents of the applicant and a business plan are submitted to the Central Bank. The specific documents required for the license are not listed by the Central Bank but the applicant should expect to be notified if additional documents are necessary for the process to be finalized. The New Banking Law provides that the Central Bank should issue its acceptance within 60 working days from the date all documents and conditions are met. If the applicant does not receive a decision within 60 working days, then this would mean the Central Bank has rejected the application.

UAE lenders who enter into financial arrangements with a borrower in the UAE without a license may face imprisonment and/or a fine and the relevant institution may be liable for civil and criminal claims.

LICENSING REQUIREMENTS IN THE DUBAI INTERNATIONAL FINANCIAL CENTRE (DIFC)

The principal regulator for regulating financial services within the DIFC is the Dubai Financial Services Authority (DFSA). An individual or entity based in the DIFC which provides a financial service must be authorized by the DFSA by obtaining the appropriate license.

An entity who wishes to satisfy the eligibility requirements in the DIFC must be structured as any one of the following forms of business:
limited liability company; company limited by shares; limited liability partnership; protected cell company; investment company; branch of foreign company or partnership; or special purpose company.

The consequences of licensing violations can be severe. If a lender does not satisfy the requirements, then the DFSA (under the regulatory law and DFSA’s Enforcement Rulebook) can enforce the following actions as punishment:

- a fine of US$100,000 per contravention; damages or restitution;
- injunctions and restraining orders; corporate penalties – unlimited fines through the Financial Markets Tribunal (FMT); and
- a banning order through the FMT.

As a consequence of violating the Financial Services Prohibition section of the regulatory law, lenders will also face censure by way of publication of any enforcement action leading to critical reputational damage and the loan arrangement may also be considered unenforceable.

**Borrowing**

**MORTGAGE FOR PROPERTY**

In the last quarter of 2013 the Central Bank issued set of regulations (Regulations) on mortgage lending which defines the eligibility of various categories of borrowers based on a loan-to-property value ratio (LTV). The primary aim of the Regulations is to ensure that banks, finance companies and other financial institutions providing mortgage loans to UAE nationals and expatriates do so in accordance with best practice and have control frameworks in place. The Regulations applies without exemption to banks and institutions providing Shari’a-compliant loans for the purchase of properties.

Whether these Regulations would still be in force or new set of regulations would be issued by the UAE Central Bank following the implementation of the New Banking Law, remains to be seen. As of now, these Regulation would appear to continue to apply as they are still made available to banks in the Central Bank’s website.

Pursuant to these Regulations, the following LTV requirements apply.

**UAE NATIONALS (INCLUSIVE OF GULF CORPORATION COUNCIL (GCC) NATIONALS)**

- Properties >AED 5 million, the LTV = 80% of the property value
- Properties <AED 5 million, the LTV = 70% of the property value
- Off-plan properties, the LTV = 50% of the property value

Each borrower is only entitled to seek a loan for one property falling within these two categories and therefore it would appear that these LTV ratios are intended for owner occupiers.

If UAE nationals seek loans for a second home or investment property, the LTV must not exceed 65% of the value of the property.

**NON GCC NATIONALS**

- Properties >AED 5 million, the LTV = 75% of the property value
- Properties <AED 5 million, the LTV = 65% of the property value
- Off-plan properties, the LTV = 50% of the property value

Each borrower is limited to one loan for the purchase of properties within these categories.

In the event of a second home or an investment property purchase by a non-UAE national, the Regulations state that the maximum loan available will be 60% of the value of the property.

UAE Law No. 2 of 2015 concerning Commercial Companies provides that shareholders in LLCs can pledge security, and that such pledges must be made in accordance with the company’s memorandum and articles of association, and be notarized. For more information, see Giving and taking guarantees and security.

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What are common lending structures?

Lending in the UAE can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents which fulfil certain roles for the finance parties), and are more highly structured, involving more complex documentation. Larger financings will typically be done on a ‘club’ or syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project, real estate facilities, trading finance and letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

Shari'a and Islamic finance

Islamic banking and finance transactions are based on Islamic principles and jurisprudence (together referred to as Shari'a or Islamic law) which is derived from a number of sources, including the Qu'ran. Islamic finance structures and techniques have developed in accordance with Shari'a principles and these principles must be adhered to when deciding whether a proposed financing structure or product is Islamically acceptable.

The key principles are as follows:

- **No interest** – Under Shari'a, money is regarded as having no intrinsic value and also no time value. The payment and receipt of interest (riba) is prohibited under Islamic law and any obligation to pay interest is considered to be void. This rule also prevents a financier from charging penalties and/or default interest.

- **No uncertainty** – Uncertainty (or gharrar), particularly any uncertainty as to one of the fundamental terms of an Islamic contract (such
as subject matter, price or delivery), is considered to be void under Shari’a. This principle is fairly broad as it requires certainty on all fundamental terms of a contractual arrangement.

- **No speculation** – Contracts which involve any speculation are not permissible (haram) and are considered to be void. This does not, however, prevent a degree of commercial speculation which is evident in a lot of commercial transactions. The prohibition applies to forms of speculation which are regarded as gambling. The general test is whether something has been gained by chance.

- **Unjust enrichment/exploitation** – A contract where one party is regarded as having unjustly gained (at the expense of another) is also void. The principle also extends to the enrichment of one party who exercises undue influence or duress over the other party.

- **Investments** – The proceeds in Islamic finance should not be used for the purposes of purchasing or investing in products or activities that are prohibited. These prohibited items and activities include the manufacture and/or the sale or distribution of alcohol, tobacco, pork products, music or pornographic productions, the operation of gambling casinos or manufacturers of gambling machines – but also extend to conventional banking and insurance activities, as well as defense and weaponry.

Islamic financiers or investors work closely with Shari’a scholars – Muslim scholars who specialize in providing guidance on the application of Shari’a principles to commercial activities – to make sure that structures and products remain compliant with the rules and principles outlined above. In effect, these scholars have the controlling say in whether or not a particular structure, product or document should be approved. However, it is important to note that Shari’a is not a codified system of law and interpretations of the key principles can vary, particularly between the different ‘schools of thought’ within Islam.

Islamic principles do not prohibit a financier in an Islamic finance transaction from making a profit, rental or other return on its asset or investment. To that end, a number of contemporary structuring techniques (or Islamic contracts) have developed which allow Islamic bankers to structure transactions and products in a way that comply with Islamic principles while also replicating the economics of conventional loans and products. Alternatively, a structure may demonstrate that the financier has assumed some of the commercial risk inherent in an underlying transaction or business venture. Sometimes these structures or approaches can be combined.

**SOME EXAMPLES OF SHARI’A CONTRACTS**

- **Sukuk** – These are a type of certificate or note (often called Islamic bonds) which represent a proportionate interest (sometimes also described as a participatory interest) in an underlying asset or investment. They are generally considered to be debt securities (akin to bonds) which, depending on the underlying asset or transaction, can be traded in the secondary market. The Sukuk certificates are often ‘layered’ on top of an underlying Islamic financing technique which is intended to derive a return from an underlying asset or investment (such as Ijara – see below).

- **Ijara** – This is Islamic financing’s equivalent of leasing and is often described as a hybrid between an operating lease and a finance lease. In general terms, the financier will act as lessor and the borrower entity will act as lessee and will pay rentals to the lessor.

- **Murabaha** – The financier will buy an asset or a commodity from a supplier and will then on-sell the asset to the customer on deferred payment terms at an agreed marked-up price (cost price plus profit).

- **Wakala** – This is an agency relationship between an investor or principal (muwakkil) and the agent (wakil).

- **Istisna’a** – This is essentially a sale contract whereby the seller or manufacturer undertakes to deliver a specific asset according to certain agreed specifications. The price of the asset and the date of delivery are specified at the outset.

- **Mudaraba** – This is a contractual arrangement between investors (rab al-maal) and a manager (mudareb). The investors typically put up capital which the manager then invests.

*Last modified 23 Jan 2020*

**What are the differences between lending to institutional / professional or other borrowers?**

Lending to institutional/professional borrowers is subject to different regulatory oversight and may be less burdensome from a compliance perspective.

The Central Bank issued regulations No 29 of 2011 regarding Bank Loans & Services Offered to Individual Customers. The regulations control lending activities and excessive charges by banks and aim to protect banks by regulating lending and encouraging banks to carry out detailed due diligence on their potential borrowers. The regulations enable individual customers to borrow only up to 20 times their...
salary or monthly income and requires that repayment instalments should not exceed 50% of the borrower’s gross salary or any regular income from a specific source. With the introduction of the New Banking Law, it is expected that a new set of regulations for loans made available to consumers will be issued in the next 2-3 years.

For more information, see Lending and borrowing – restrictions.

Do the laws recognize the principles of agency and trusts?

The concept of ‘trusts’ and ‘trustees’ are more regularly referred to in the UAE as ‘agent’ or ‘security agent’ or due to concerns around trusts not being recognised onshore in the UAE. By contrast, agency is a largely recognized concept and often utilized in onshore, offshore (including the Dubai International Finance Centre) and Islamic finance structures. In Islamic transactions, if the transaction is structured in compliance with Shari’a, the addition of an agent is not uncommon, in order for them to represent a group of lenders and guard their interests.

Further, onshore and offshore entities in the UAE may require a security agent to be employed, particularly in the context of security over certain type of assets (such as shares) which is granted in the region and can only be enforced by local institutions or entities that have specific licenses. Typically, this only becomes an issue upon enforcement; however, lenders should be mindful of this as it may affect the value they place on such types of security.

It is also worth noting that parallel debt language is often used to support a security agent’s rights to claim against a security provider in the UAE.

Are there any other notable risks or issues around lending?

Financial assistance

Under the Companies Law it is not possible for a public joint-stock company (PJSC) target, or any of its subsidiaries, to provide any financial aid (such as loans and guarantees) that will assist a purchaser in acquiring its shares. However, limited liability companies are exempt from such restrictions under Ministerial Resolution No. 272 of 2016 on the Implementation of Certain Provisions of the PJSC to LLCs.

Standard form documentation

Most syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association. Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

Are there any other notable risks or issues around borrowing?

Borrowers may often be limited in the kinds of transactions and financings they can enter into, particularly in cases where the transaction is highly structured and involves the issuance of debt securities. In addition, restrictions arise when the relevant financiers or borrowers are Shari’a-compliant. However, most of the major international lenders have their own Islamic banking desks and many retain Shari’a advisory boards. Such institutions are growing more comfortable with the main Islamic financing mechanisms.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?
Some of the key areas affecting the giving of guarantees and security are as follows.

**Capacity**

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers to do so. In general, the directors'/managers' duties requirements under the Companies Law require the directors/manager to 'preserve' the company's rights which is similar to the English law requirement that directors act in the best interests of the company. However, provided that the giving of a guarantee or the granting of security is considered to be in the best interests of the group as a whole, there should be no issues from a directors' duties perspective. This should be recorded in the authorizing resolutions when the security is granted.

**Public joint-stock company (PJSCs)**

Special care needs to be taken if a PJSC is granting security or giving a guarantee. Article 154 of the Companies Law requires directors to have express powers to enter into mortgages (over moveable and immoveable property). Consequently, a separate shareholders’ resolution will be required if such express powers are not already provided in, for instance, the company's constitutional documents. Although the legislation would appear to capture LLCs as well, it was clarified by a 2016 Ministerial Decision that this requirement does not apply to LLCs.

In addition, there is a broad prohibition on PJSCs providing financial assistance for the purchase of its own (or of its holding company's) shares. It is important to note that there is no 'whitewash' procedure available of the type seen in other jurisdictions.

**Insolvency**

Guarantees and security may be at risk of being set aside under the UAE Insolvency Law if granted by a company within a certain period of time prior to the onset of insolvency.

**No concept of trust**

There is no concept of trust as exists in common law jurisdictions and the use of a local security agent holding security for the benefit of lenders through a parallel debt mechanism has become market practice (although has not been tested by the courts).

**Notarization**

With respect to security over certain assets (such as share security taken with respect to certain companies), it is necessary that the signing of the security is notarized in front of a UAE notary public. In order to notarize the signing of a document, the notary public will generally require all relevant documents (such as constitutional documents of the grantor, required board or shareholder resolutions and licenses to be translated into Arabic, notarized in the relevant jurisdiction of the shareholders and then legalized both in the country of the shareholder and then brought onshore and stamped by the Ministry of Justice).

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**What are common types of guarantees and security?**

**Common forms of guarantees**

Guarantees are common in the UAE and it is also quite common to see personal guarantees given in relation to a loan for commercial purposes.

Guarantees are specifically codified in Chapter V of the Civil Code. Separate rules apply to bank guarantees under the Commercial Transactions Law. Although UAE courts have taken different approaches as to whether a guarantee of a bank loan is a civil or commercial transaction, it is common to disapply certain provisions of the Civil Code which may have an impact on the lenders’ position (such as Article 1092 of the Civil Code which provides that a creditor must claim for a due debt within six months from the date of maturity).

The Commercial Code recognizes bank guarantees (which often take the form of a bond). Certain rules apply to these instruments such as assignment and time limits and there is a provision that 'in exceptional circumstances', the guarantor can successfully resist payment. It should be noted that the courts have been reluctant to apply this provision.
Types of security

Security over real estate and real estate interests (such as usufructs and musatahas (akin to a development agreement) are taken by way of mortgage. Some of the Emirates (and free zones) have specific laws dealing with mortgages but in the absence of legislation, mortgages are governed by the Civil Code. Although the practices of the relevant registrars may differ (and the practice at a particular registrar might evolve as well), generally mortgages over real estate may only be granted in favor of a bank which is licensed by the UAE Central Bank, be translated into Arabic and notarized prior to registration.

In relation to moveable property, UAE Law No. 20 of 2016 on the Mortgage of Moveable Assets to Secure a Debt (Pledge Law) governs how security is taken over certain classes of moveable assets such as accounts, trade payables, equipment and tools, goods and raw materials and agricultural products. The Pledge Law provides that security over such moveable property should be by way of written security agreement or mortgage and, contrary to the previous position in the UAE, allows security to be taken over property without demonstrating possession and also allows security to be taken over future property (including bank accounts with fluctuating balances). It is therefore possible to take security over such moveable property which is similar in effect to an English debenture or law floating charge (provided that the requirements of the Pledge Law are adhered to).

We note, however, that the Pledge Law does not govern security over all moveable assets, and so care should be taken when securing a particular asset class to ensure that the security is in the correct form. For example, the Pledge Law specifically excludes insurance contracts and proceeds from its operation, meaning that any security taken over insurance contracts and proceeds should follow the traditional form (which is security by way of assignment). Security over ships, aircrafts and vehicles are also subject to different laws and regulations in the UAE. Depending on the nature of a transaction, this may require the security document to be notarized and for registration to be made in an appropriate asset register.

Due to the introduction of the new Companies Law, it is possible to take security over the shares in a company, including onshore LLCs. (It should be noted that the position differs from free zone to free zone and would need to be checked.) The process for taking security over pledges of shares should be checked with the relevant department in each Emirate as the process differs. However, generally the practice has been that this security may only be granted in favor of a bank licensed to carry out business in the UAE and is subject to notarization requirements.

Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

The Civil Code provides that a lender should not be obliged to first prove the bankruptcy of the borrower before claiming against the guarantor and that the borrower and the guarantor shall not be discharged from the balance of the debt if the parties agree a composition in relation to part of the debt. These provisions can be set aside.

There is no concept of a deed under UAE law and accordingly, guarantees should be executed in the same manner as any other contract. There is also no requirement for guarantees to be notarized, although it is quite common for the signature of a personal guarantor to be witnessed.

However, if a guarantee were to be brought before a local court, it would need to be translated into Arabic by a certified translator and the Arabic version would prevail– for this reason, parties sometimes require a guarantee to be translated into an agreed version of Arabic prior to execution although there is no universal practice in this regard.

Giving or taking security

As mentioned above, there is no concept of a deed under UAE law. Depending upon the type of security and where the asset is located (onshore or in a free zone), there may be a prescribed form of security (for example, the Dubai Land Department requires a short form mortgage to be registered, so a practice has developed that both a long form and short form mortgage are signed).

In relation to security taken over moveable property pursuant to the Pledge Law, in order to perfect such security it is necessary to register the security on the register established under the Pledge Law, which is known as the “Emirates Moveable Collateral Registry”. The Emirates Moveable Collateral Registry is an online registry, and so in order for a secured party to effect a registration with this registry it is
a matter of the secured party creating an online account with the registry and then submitting via an online form the required information about the secured property and the security provider.

The registration requirements in relation to other forms of security should always be checked as there are time periods required by some free zone registries.

Financial regulation

Law and regulation

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

**Generally**

**LEGISLATION IN THE UAE**

- The Consolidated Constitution of the UAE (as amended) – (Article 7 establishes the Shari'a law as a fundamental source of legislation)
- UAE Central Bank Federal Law No. 14 of 2018
- UAE Federal Law No. 8 of 2018 on Financial Leasing
- Central Bank Circulars
- UAE Basel II Guidelines for Banks
- Corporate Governance Guidelines 2009
- Foreign Account Tax Compliance Act (FATCA)
- UAE Federal Law Bo. 10 of 2018 regarding Netting
- UAE Civil Code Federal Law No. 5 of 1985
- UAE Commercial Transactions Law Federal Law 18 of 1993
- UAE Commercial Companies Law Federal Law No. 2 of 2015
- UAE Insurance Law Federal Law No. 6 of 2007
- Central Bank Framework on Stored Values and Electronic Payment Systems of 2017
- UAE Federal Law No. 9 of 2018 (Regarding Public Debt)

**FREE/SPECIAL ECONOMIC ZONES IN THE UAE**

There are over 40 free zones in the UAE currently which are set up under the laws of its host emirate regarding free zone companies and establishments. There is no federal free zone authority (although one was discussed extensively in 2007 and 2008) those free zones are given a degree of freedom to self-regulate so long as such regulation does not violate the provisions of local/national law, or constitute a violation of public morals or be contrary to public interest.
In addition to the free zones generally, Abu Dhabi Global Market (ADGM) and Dubai International Financial Centre (DIFC) are two financial free zones which have their own court system and legislative capacity.

While we do not cover the free zones in any great detail on this site, it is important to recognize that ADGM and DIFC have signed memoranda of understanding and mutual recognition with the local courts and/or federal court systems in their respective Emirates which means a decision from either of ADGM or DIFC can be enforced and executed directly through the local courts respectively without the case being heard ab initio.

- UAE Federal Law No. 8 of 2004 on the Financial Free Zones of the UAE
- DIFC Laws and Regulations
- Dubai Financial Services Authority (DFSA) Laws and Regulations
- ADGM Laws and Regulations
- The Free Zones Laws and Regulations
- Emirates Securities and Commodities Authority
- UAE Insolvency Law Federal Law No. 9 of 2016
- UAE Penal Code Federal Law No. 3 of 1987
- UAE Decree-law No. 20 of 2018 on Anti-Money Laundering

**Consumer credit**

UAE Credit Information Law Federal Law No 6 of 2010 and Cabinet Resolution 16 of 2014 (information requirements and sharing)


**Mortgages**

UAE Civil Code

UAE Commercial Transactions Law

UAE Central Bank Circular October 2013 established a loan to value ratio for mortgages

Dubai Law No. 8 of 2008 and 9 of 2009

Dubai Mortgage Law Decree No 31 of 2016

UAE Law No. 20 of 2016 on the Mortgage of Moveable Assets to Secure a Debt and its executive regulations (Cabinet Resolutions No. 5 and No. 6 of 2018). This law which came into effect on 15 March 2017 has established the Emirates Moveables Collateral Registry which is an online registry allowing the registration of security over moveables in the UAE. This law is perceived as a much welcomed addition to the UAE financial landscape (especially for cross-border financing).

**Corporations**

UAE Civil Code

UAE Commercial Companies Law Federal Law No. 2 of 2015

**Funds and platforms**

SCA Chairman's Regulation No. 9 of 2016

SCA Chairman's Regulation No. 3 of 2017
Taken together, these regulations establish procedures for licensing, management, offer document contents, subscription, issuance and listing of funds.

Funds are listed on the Dubai Financial Market and NASDAQ Dubai. There are many trading platforms available including online trading platforms.

**Other key market legislation**

The United Arab Emirates is a federation of seven independent states, each of which has judicial capacity. In addition, through changes to the UAE Constitution, special free economic and financial free zones have been set up to attract foreign direct inward investment, each of which has its own regulatory authority.

It is possible that in order to establish the regulatory framework applicable to a company, fund, investment scheme, or activity that one or more and potentially all of the following legislation will need to be reviewed:

- UAE Federal legislation;
- legislation passed by each individual emirate but note:
  - Ajman, Fujairah, Sharjah, and Umm Al Quwain generally follow the same or substantially similar laws and adhere to the Federal Court System; and
  - Dubai, Abu Dhabi and Ras Al Khaimah have derogated from the Federal Court System and each have their own court system or judicial departments (independent from the federal system) – they pass laws which affect their emirate alone;
- DIFC Legislation;
- The Law and Regulations enacted in each other free zone;
- DFSA Rules and Regulations;
- ADGM Legislation;
- UAE Central Bank Circulars and Resolutions; and
- UAE Securities and Commodities Authority.

**Regulatory authorization**

**Who are the regulators?**

This depends on the entity, its location and the relevant regulations and laws that apply.

The UAE is a federation of seven independent emirates each of which has its own judicial capacity. The applicable laws are those federal laws passed by the federal government of the UAE but each can be supplemented by laws passed by the rulers of individual emirates.

The UAE has a federal court system which is followed in the Emirates of Ajman, Fujairah, Sharjah and Umm Al Quwain. The Emirates of Abu Dhabi, Dubai and Ras Al Khaimah have separate court systems or judicial departments (independent from the federal system).

In addition, through changes to the UAE Constitution, two financial free zones have been created (Abu Dhabi Global Market (ADGM) and Dubai International Financial Centre (DIFC)) which have their own court systems based on the federal Civil Code but English common law.

The Central Bank of the UAE (Central Bank) and the Securities and Commodities Authority (SCA) are the main regulatory bodies for financial services in the UAE. Pursuant to Federal Law No. 14 of 2018 (New Banking Law), the Central Bank regulates financial institutions, including those who wish to provide financing and engaged in financial licensed activities in or from the UAE. The New Banking Law replaces and repeals the Federal Law No. 10 of 1980 and Federal Law No. 6 of 1985 (together the Old Banking Laws).

Taking this together when considering the question of regulation of a particular entity or activity, it may be possible that any of the
following regulatory bodies may have authority:

- UAE Central Bank;
- UAE Securities and Commodities Authority;
- Abu Dhabi Global Market Authority Courts;
- Dubai International Financial Centre Courts;
- Dubai Financial Services Authority;
- a relevant Free Zone Authority;
- UAE Penal Code; and
- laws and regulations passed by individual emirates.

What are the authorization requirements and process?

This is dependent upon what type of business/financial activity the firm would be participating in the UAE. Secondly, it depends where the firm is located either onshore UAE or in one the economic free zones (in the case of finance, most likely to be in the Dubai International Financial Centre (DIFC) or Abu Dhabi Global Market (ADGM). The institutions listed in our answer to Regulatory authorization – regulators (ie the Central Bank, DIFC, Dubai Financial Services Authority and ADGM etc) have their own authorization requirements and processes in place.

If in doubt, the first port of call is the relevant Emirate’s Economic Development Department who can advise further.

What are the main ongoing compliance requirements?

Whether the firm is located onshore or in a free zone, the firm will have ongoing compliance requirements. For example, if the firm is located in the Dubai International Financial Centre (DIFC) it will have to apply for an annual trading license from the Registrar of Companies and will need to comply with the relevant regulations and rules found in the Dubai Financial Services Authority (DFSA) Handbook. Furthermore, from time to time, the Central Bank will issue circulars with updated regulations/rules which financial firms will need to comply. In order to be clear which compliance regulations apply it is necessary to consider each case on its specific facts. But in any case, failure to comply with ongoing compliance of the relevant regulator can result in sanctions for firms including severe fines.

What are the penalties for failure to be authorized?

Depending on the individual circumstances, this could lead to corporate fines and trading privileges being removed, individual directors and corporate officers being held accountable personally for breaches of fiduciary duties, and in the case of compliance breaches and crimes this can include fines and/or terms of imprisonment of varying degrees of severity.

UAE lenders who enter into financial arrangements with a borrower in the UAE without a license may face imprisonment and/or a fine and the institution may be liable for civil and criminal claims. The relevant UAE authorities, such as the Central Bank of the UAE (Central Bank) and the Securities and Commodities Authority (SCA) may in addition impose administrative sanctions and fines.

In the case of the DIFC, if a relevant lender does not satisfy the requirements of the Dubai Financial Services Authority (DFSA), under the regulatory law and DFSA’s Enforcement Rulebook the DFSA can enforce the following actions as punishment:

- a fine of US$100,000 per contravention;
- damages or restitution;
- injunctions and restraining orders;
• corporate penalties – unlimited fines through the Financial Markets Tribunal (FMT); and
• a banning order through the FMT.

As a consequence of violating the Financial Services Prohibition section of the regulatory law, lenders will also face censure by way of publication of any enforcement action leading to critical reputational damage (and the loan arrangement may also be considered unenforceable).

Regulated activities

What finance and investment activities require authorization?

Generally

Everything that is classified as financing and investment activities under various legislation.

Any licensed financial activities onshore in the UAE is governed by the UAE Central Bank. Depending on the category of activity, different rules and regulations and circulars will apply. Accordingly, interested parties should refer to the UAE Central Bank website where all current laws, regulations and circulars are provided. The scope of licensed financial activities is relatively broad and are listed in the New Banking Law. The board of directors of the Central Bank has also the power to review the list of licensed financial activities and add, exempt or remove certain activities from that list.

Any offshore entities conducting business activities within the UAE will need to be appropriately licensed by the UAE Central Bank. The types of licenses generally issued by the UAE Central Bank include commercial bank, investment companies and investment consultation, branches of foreign licensed institutions.

Anticipated regulatory changes

We understand that the UAE is contemplating reforming the financial services sector’s regulations, which is intended to cover, among other things, custody, collective investments and broker dealing. The UAE has recently enacted the New Banking Law. As a result, a number of regulations and circulars are expected to be implemented in the next two to three years. The New Banking Law states that the Central Bank will establish an electronic guideline (i.e. a rulebook) which will include all regulations, standards, decisions and circulars issued by the Central Bank. Such electronic guideline will be published and regularly updated on the Central Bank’s website. This will be a welcome change in the UAE (and follows the position adopted by the Dubai Financial Services Authority).

However, there currently exists something of a vaccum and market participants and practitioners should pay a close attention to the upcoming implementing regulations.

Are there any possible exemptions?

Tolerated practices

While the relevant legislation clearly prohibits entities or persons from engaging in regulated activities (unless licensed to do so), under the Old Banking Laws (i.e. Federal Law No 10 of 1981 and Federal Law No. 6 of 1985) the UAE Central Bank would not always strictly monitor performance within the regulations. These are generally referred to as the ‘tolerated practices’ in the UAE.

To fall within the scope of the tolerated practices, the activity in question must be:

• carried out from offshore and not involve local currency (being dirhams);
• ‘low profile’ (that is, targeted and marketed to a defined and select group of non-retail customers); and
• one-off (anything that involved approaching residents on an unsolicited basis, road shows etc are less likely to fall within the scope of
It is important to note that the concept of 'tolerated practices' is neither a legal concept nor officially recognized by the UAE Central Bank. While it has not been tested in the UAE courts, we are not aware of any examples of any action being taken against foreign entities under the Old Banking Laws. Whether these tolerated practices will be more closely regulated or supervised by the Central Bank under the New Banking Law remains to be seen.

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**Do any exchange controls or other restrictions on payments apply?**

There are no foreign exchange controls in the UAE or restrictions on payments, except to the extent these may violate anti-money laundering rules or international sanctions.

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**What are the rules around financial promotions?**

Under the New Banking Law, financial promotion refers to any form of communication by any means, aimed at inviting or offering to enter into any transaction, or offering to conclude any agreement related to any of the Licensed Financial Activities. Since such communications can influence consumers, entities are restricted from communicating financial promotions unless they are licensed to do so by the UAE Central Bank.

**Exemptions**

Even though engaging in regulated activities is clearly prohibited (unless the person is licensed to do so), the UAE Central Bank has tolerated certain practices under the Old Banking Laws. To fall within the scope of a tolerated practice, the foreign entity must ensure that, for instance:

- only a discrete and defined group of pre-identified clients (who are either institutional, professional or sophisticated clients) are approached;
- no mass advertising campaign is carried on in the UAE;
- the person marketing the product or service is not resident in the UAE; and
- marketing activities are performed from outside the UAE (except for 'low profile' activities).

It is important to note that the concept of 'tolerated practices' is neither a legal concept nor officially recognized by the UAE Central Bank. Whilst it has not been tested in the UAE courts, we are not aware of examples of foreign entities being found liable under the Old Banking Laws. Whether these tolerated practices will be more closely regulated or supervised by the Central Bank under the New Banking Law remains to be seen.

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**Entity establishment**

**What types of legal entity are generally used to undertake financial or investment activity?**

**Generally**

This question varies according to the type of financial activity being practiced and the rules of the emirate and free zone in which the vehicle is set up.

Pursuant to the New Banking Law:
• Banks shall take the form of public-joint stock companies (through an incorporating law or though a decree). This does not apply to branches of foreign banks operating onshore UAE. As a general rule, a Bank shall at least have 60% UAE national shareholding.

• Other Financial Institutions (i.e. any juridical person other than a Bank) carrying one or more Licensed Financial Activities may take the form of joint-stock companies or limited liability companies in accordance with the rules and regulations issues by the board of directors of the Central Bank.

• Exchange houses and monetary institutions may be a sole proprietorship or take any other form legal form in accordance with the rules and regulations of the board of directors of the Central Bank.

In the Dubai International Finance Centre (DIFC), the type of entity and activity will generally depend on which category of license being applied for.

In each case this question needs to be examined on a case-by-case basis depending on the financial or investment activity to be carried out.

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Is it possible to conduct lending or investment business through a branch or establishment?

Generally, it is not possible to engage in lending or investment activities through a branch office.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

• operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
• applying technology to leverage and optimize the lending platform and user experience; and
• connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Products under development are generally understood to include:

• virtual credit cards;
• consumer loans;
• student lending products;
• small and medium-sized enterprises (SME) lending; and
• residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over
the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P)-type structures, often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds, as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called ‘blocks’ or algorithm functions called ‘hashes’.

Each block includes unique features, such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a ‘proof of work’ process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open (‘permissionless’ or ‘unpermissioned’) or structured within a private group (‘permissioned’).

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an ‘address’). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the
form of so called ‘smart contracts’. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of the transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
• compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

The Abu Dhabi Global Markets free zone has set out guidance on its approach to ICOs and virtual currencies under the Financial Services and Markets Regulations (see here). The Dubai Financial Services Authority, the financial regulator of the Dubai International Financial Centre, has stated that it does not regulate any of these types of offerings and that ‘these offerings should be regarded as high-risk investments’.

It should be noted that any promotion of securities in the UAE (outside of the financial free zones) will require registration with the Securities and Commodities Authority (SCA) unless a qualified investor exemption applies (which does not include individuals). Public offers of securities in the UAE are outside the scope of our answer to this question.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as ‘robo advisors’ are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The relevant regulation and regulator will depend on where an entity is operating in the UAE.

The UAE is a federation of seven independent emirates:

• Abu Dhabi;
• Ajman;
• Fujairah;
• Sharjah;
• Umm Al Quwain;
• Dubai; and
• Ras Al Khaimah.

The majority of regulation relevant to FinTech companies operating in onshore UAE will derive from federal laws.

The Central Bank of the UAE (Central Bank) and the Securities and Commodities Authority (SCA) are the main regulatory bodies for financial services in the UAE. Pursuant to Federal Law No. 14 of 2018 (Banking Law), the Central Bank regulates financial institutions,
including those who wish to provide financing in or from the UAE. A FinTech company operating in onshore UAE conducting, for instance, peer-to-peer (P2P) lending-type activities, would require a license under the Banking Law in order to legally operate.

In addition, through changes to the UAE Constitution pursuant to Federal Law No. 8 of 2004, two 'Financial Free Zones' have been created:

- Abu Dhabi Global Market (ADGM); and
- Dubai International Financial Centre (DIFC).

These two financial free zones are entitled to make their own financial regulations and are consequently regulated separately from onshore UAE, certainly in respect of financial activities. The regulators are the Financial Services Regulatory Authority (FSRA) for ADGM and the Dubai Financial Services Authority (DFSA) for DIFC.

Both of these financial free zones have specific licensing regimes for companies wishing to operate in the financial services sector. Interestingly, however, both ADGM and DIFC have created sandbox-type regimes for FinTech companies specifically, namely: the ADGM RegLab and the DIFC’s Innovation Testing License.

Although FinTech is at an early stage of development in the UAE, the UAE is promoting a number of initiatives to be at the forefront of FinTech developments, such as:

- FinTech Hive at the DIFC (see here);
- Dubai Future Accelerators (see here);
- Dubai Blockchain Strategy (see here); and
- the UAE’s National Innovation Strategy (see here).

**Electronic payments platforms and regulation of peer-to-peer lenders**

**UAE**

The Regulatory Framework for Stored Values and Electronic Payment Systems (Payment Systems Regulations) issued by the UAE’s Central Bank came into effect on 1 January 2017. The Payment Systems Regulations apply to Payment Service Providers (PSPs), which are effectively any entity that provides digital payment services (including using electronic, mobile or magnetic means but excluding credit and debit card payments) within the UAE.

The Payment Systems Regulations further define the concept of a PSP into four distinct sub-categories:

- **Retail PSP** – authorized commercial banks and other licensed PSPs offering retail, government and P2P digital payment services as well as money remittances;
- **Micropayments PSP** – PSPs offering micropayments solutions facilitating digital payments targeting the unbanked and under-banked segments in the UAE;
- **Government PSP** – federal and local government statutory bodies offering government digital payment services; and
- **Non-issuing PSP** – non-deposit taking and non-issuing institutions that offer retail, government and P2P digital payment services.

The Payment Systems Regulations also apply to so-called ‘Stored Value Facilities’, defined as non-cash facilities, whether in electronic or magnetic form, that are purchased and used by an individual or legal person to pay for goods or services. The Payment Systems Regulations provide that these services include:

- cash-in services (the exchange of cash for digital money, which is placed in a payment account);
- cash-out services (the exchange of digital money for cash, which is taken out of the payment account);
- retail credit/debit digital payment transactions;
- government credit/debit digital payment transactions;
- P2P digital payment transactions; and
• money remittances.

The Payment Systems Regulations also provide a list of services excluded from the Payment Systems Regulations as follows:

• payment transactions in cash without any involvement from an intermediary;
• payment transactions using a credit card/debit card;
• payment transactions using paper checks;
• payment instruments accepted as a means of payment only to make purchases of goods/services provided from an issuer/any of its subsidiaries (ie closed-loop payment instruments);
• payment transactions within a payment/settlement system between settlement institutions, clearing houses, central banks, and PSPs;
• payment transactions related to transfer of securities/assets (including dividends, income, and investment services);
• payment transactions carried out between PSPs (including their agents/branches) for their own accounts; and
• ‘Technical Service Providers’.

In the above exclusions, ‘Technical Service Providers’ is perhaps the least apparent but these are effectively defined in the Payment Systems Regulations as an entity that ‘facilitates the provision of payment services to PSPs’, without at any time being in possession of or transferring any funds. Examples cited include data processors, authentication service providers, payment terminal maintenance companies and network providers.

DIFC

The DIFC Innovation Testing License provides a controlled environment for a firm to develop and test FinTech ideas without being subject to all the requirements that would otherwise apply to it as an ‘Authorized Firm’ under the DIFC rules and regulations. To be considered for this type of license, a firm must:

• involve innovation and the use of FinTech (ie have a business model, product or service that uses new, emerging or existing technology in an innovative way, and in a way that brings a new benefit to consumers or industry);
• involve an activity that, if carried on in the DIFC, would amount to a ‘Financial Service’ (or combination of ‘Financial Services’) within the scope of the DFSA’s regulatory regime, for example, arranging deals in investments or advising on financial products;
• be ready (or soon be ready) to start testing with customers or industry; and
• intend to roll out its business on a broader scale in or from the DIFC after it has successfully completed testing.

The testing period will be for a finite period of time, normally six to 12 months. In exceptional cases, the DFSA will consider extending that period.

Beehive was the first P2P lending platform to receive a license from the DFSA to operate in the DIFC.

ADGM

According to the ADGM RegLab brochure (‘The Regime For FinTech Innovation’), the ADGM RegLab is for all participants active in the FinTech space, from startups to existing, regulated companies. To qualify, the participant must be able to demonstrate that it has an innovative technological solution that is at the stage of development ready for testing. The solution should contribute to the development of the financial sector in UAE. In particular, it should:

• promote growth, efficiency or competition;
• promote risk management and better regulatory outcomes; or
• improve consumer choices.

The first five FinTech companies to be admitted to the ADGM RegLab were announced in May 2017 (see here).

Regulation of payment services
Organizations that wish to commence and maintain digital payment services must comply with the Payment Services Regulations.

If such a service falls within the Payment Services Regulations, a company needs to make sure that they (among other things):

- apply for and obtain the requisite licenses/approvals from the Central Bank, before commencing new digital payment services;
- have the facility to store and retain all user and transaction data exclusively within the borders of the UAE (excluding the UAE financial free zones) for a period of five years from the date of the original transaction;
- three months before the implementation of any outsourcing of an operational function, have written approval from the Central Bank and ensure such services are provided onshore in the UAE under a contract which satisfies the relevant safeguard requirements;
- prepare customer service agreements which meet the required standards of the regulation and ensure those agreements are put in place with all users; and
- do not use or process any form or type of virtual currency.

Application of data protection and consumer laws

At a UAE federal law level, there is no specific federal data protection or privacy law, although there are several laws which relate to data protection and privacy. Within each UAE emirate, the applicable law is a combination of:

- federal law, which applies, in the main, across the UAE;
- the law of the emirate in which business is being undertaken (to the extent that this law is different to, but not inconsistent with, the federal law); and
- free zone legislation (such as ADGM and DIFC legislation).

The Federal Law No. 24 of 2006 on Consumer Protection defines consumer's rights and obligations and outlines certain protection measures to fight monopoly, overpricing and fraudulent commercial activities against consumers.

Money laundering regulations

The UAE Decree-law No. (20) of 2018 on Anti-Money Laundering and Combating the Financing of Terrorism and Financing of Illegal Organisations provides a list of criminal offences and penalties, as well as the institutional arrangements regarding anti-money laundering and combating terrorism financing. Both DIFC and ADGM have their own anti-money laundering regimes as well.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdcube or Crowdfunder.
There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

In the UAE, crowdfunding was not until recently provided for and those seeking to raise capital by such means would have had to work within the general financial regulatory framework in the UAE, including in relation to offers of securities. However, in August 2017 the Dubai Financial Services Authority (DFSA) launched its crowdfunding regulatory framework for loan and investment-based crowdfunding platforms, the first such framework among the Gulf Cooperation Council countries.

**ACCELERATORS**

Both the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM) have their own accelerators, as more fully described in FinTech products and uses – particular rules; performing financial services in or from the DIFC or the ADGM requires a license from the DFSA or the Financial Services Regulatory Authority (FSRA) respectively.

**Venture capital and debt**

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund, examples of which include Santander InnoVentures and Citigroup's Citi Ventures. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through VC.

**Warehouse and platform funding**

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, which bring individual borrowers and lenders together without the involvement of traditional banks. Beehive was the first P2P lending platform to receive a license from the DFSA to operate in the DIFC.

**Senior bank debt and capital markets funding**

As in many jurisdictions, listings via equity capital markets or debt capital markets are an option only for those of a certain size (local securities laws present various hurdles). Other debt financing options may be possible but, at this stage, equity and VC investment is a more common funding course for FinTech developers/users.

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.
Incentives and reliefs

One of the biggest attractions for corporates wishing to setup in the UAE (whether offshore or in the free zones) is the fact that the UAE is a (near) tax-free jurisdiction. Setting up in onshore UAE is more difficult for international firms given the rules around local ownership; however, the financial free zones are specifically setup to incentivize international corporates. They also offer clients a 50-year guarantee of zero taxes on corporate income and profits, complemented by the UAE’s network of double taxation avoidance treaties.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party’s rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.

- **Assignment** – An assignment is a transfer of rights only. There is some doubt as to whether an assignment can be done without an acknowledgment of the debtor and case law varies from Emirate to Emirate. For this reason, it is good practice to ensure that the debtor consents to and acknowledges any assignment.

- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Similar to other jurisdictions, loan transfers are commonly documented using standard form contracts made available by the Loan Market Association. However, as mentioned in Giving and taking guarantees and security, as the concept of trust does not exist in the UAE, it will be necessary to consider any security arrangements governed by UAE law and it would be usual for a transferee to accede to any security agency arrangements.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan. Some key considerations include:

- **Confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;

- **Data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser. In this respect, reference should be had to UAE data protection legislation;

- **Lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;

- **Undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;

- **Transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and

- **Security arrangements** – whether it is necessary for the new lender to accede to a security agency agreement or appoint a security agent on its behalf to hold security (if the security is of a type which needs to be granted in favor of a bank who is licensed by the Central Bank to carry out business in the UAE).
Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

Article 23 of the UAE Constitution provides that: ‘The natural resources and wealth of each Emirate shall be considered the Public Property of that Emirate. Society shall be responsible for the protection and proper exploitation of such natural resources and wealth for the benefit of the national economy.’

In general, although the ownership structure of an infrastructure project varies according to its type, it is generally the case that a government or quasi-government entity will be involved in it and benefit financially from the project. The actual involvement varies on a case-by-case basis.

Energy

ABU DHABI

Abu Dhabi National Oil Company (ADNOC) and its subsidiaries are part (usually the majority shareholder) in every project regarding the exploitation of its hydrocarbons. Traditionally because the Abu Dhabi hydrocarbon industry is mature, foreign stakeholders would enter into long-term concession agreements but with respect to newer fields, some of these have been placed on a production sharing agreement basis. More detailed information about the difference between concession agreements and productions sharing agreements is available on request.

DUBAI

Dubai's hydrocarbon industry has been in decline for many years and started out with minimal reserves in comparison to the Emirate of Abu Dhabi. Previously its hydrocarbon production was done on the basis of concession agreements with strategic investors. Dubai's Emirates National Oil Company (ENOC) remains a key player but much of its activity is now on the midstream (transmission and refining and sales and marketing through its chain of petrol stations).

SHARJAH

The government works closely with one of the largest privately – owned oil companies in the Gulf, Crescent Petroleum and Crescent Enterprises, which is owned by the Jafr family, on most hydrocarbon projects, whether oil or gas,. In addition, Crescent Petroleum is a 20% shareholder of the listed company, Dana Gas. Its gas reserves are more significant than its oil reserves.

The Northern Emirates of Ajman, Fujairah, Ras Al Khaimah and Umm Al Quwain have negligible hydrocarbon resources but were viable fields to be discovered, then there is a strong possibility that they would use a similar model to that adopted by the other governments in the Emirates.

Renewables

Increasingly pressure is being put on the UAE and its Gulf Cooperation Council (GCC) neighbors to reduce their carbon footprints. Accordingly a number of Emirates are responding enthusiastically to this challenge.

ABU DHABI

Masdar City is an integrated green development company and wholly owned subsidiary of Mubadala Development Company PJSC, a state-owned holding company and wholly-owned investment company set up to diversify Abu Dhabi's economy.

In addition, Mubadala has invested in solar power and has started to consider other renewables projects such as wind and wave power. While all projects are at an early stage, there is considerable optimism that investment in solar power will continue to grow due to the
abundance of sunlight available in the UAE,

DUBAI

While not as robustly as Abu Dhabi yet, Dubai has already invested in solar power, commissioning a 200 MW solar project located in Mohamed Bin Rashid Solar Park.

Electricity and water

Each of the seven Emirates has a government-owned monopoly supplier of water and electricity services.

In summary, investment in any conventional and alternative power projects in UAE will involve significant interface and contracting with a government or quasi-government entity to some degree.

The Emirates have a nascent nuclear program which is under the direct control of the International Atomic Energy Agency but the initiatives are implemented through the Emirates Nuclear Energy Corporation.

Telecoms infrastructure

There are two majority government-owned providers of telecommunications services in the UAE, Etisalat being the older entity (set up in 1976) and Du. While the majority shareholders are government-owned or backed companies, Du has over 20% public ownership and it is listed on the Dubai Financial Market.

The regulator of the Telecommunications networks is the Telecommunications Regulatory Authority (TRA).

Transport infrastructure

This depends on the type of transport.

Generally, the Road and Transport Authority in Dubai (RTA) is responsible for roads, monorail and marine; each of which has its own section under the general supervision of the RTA.

At a federal level, transport is regulated and supervised through the Ministry of Infrastructure and Development.

Aviation

Each of Abu Dhabi and Dubai has its own international airline, Etihad and Emirates respectively. All aviation issues are regulated by either Dubai Civil Aviation Authority or the General Civil Aviation Authority for other Emirates.

Developments and investment in aviation will involve contracting with a quasi-government entity, including services contracts in the airports and around the aviation infrastructure.

Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in the UAE except to the extent that may be set out in UAE Law and an invitation to tender (ITT) for such projects.

In addition, the ownership of the infrastructure must not violate the laws of foreign ownership of land and assets by a foreign national and company laid down in the New Commercial Companies Law, Federal Law No. 2 of 2015 (CCL) or any relevant regulations and circulars issued by the UAE Central Bank.

The interested investment party will need to examine the ITT carefully to ensure it complies with any specific requirements for that project including specific procurement provisions there may be. To this end the UAE public procurement legislation may be relevant.

A particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning
and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order, and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body (e.g., a government department, or a local authority) is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval. Key sector-specific issues are flagged in the sections below.

There are specific rules governing the ownership of land in each of the seven Emirates. Some of the free zones allow purportedly 100% foreign ‘freehold’ ownership of land. However, this applies only to residential property. With the exception of nationals from other Gulf Cooperation Council countries (GCC) it is generally very difficult for foreign nationals or companies to own land to develop for commercial purposes.

It follows from the above paragraph that any foreign investors in infrastructure projects must do adequate due diligence to ensure they can secure use of the land on which the infrastructure is to be built for the entire duration of the project. Failure to secure such rights will have a serious economic effect on the project.

**Energy**

Energy projects in the UAE are complex due to arrangements in respect of licensing, subsidies and revenue flow structure. In addition, current regulations are apt to change frequently, meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how political and technology changes may impact on the overarching regulatory framework.

Since natural resources belong to the public as a whole, another issue to address in project documentation will be that of ‘sovereign immunity’ and specific warranties and waivers need to be included in the project documents.

Specifically with respect to energy infrastructure projects and power generation, the investor should pay attention to the power purchase agreement/offtake agreement/tolling agreement etc, as if the off-taker is a government or quasi-government entity, it is possible that the project will not be able to sell its power/services at a full-y commercial rate which will impact the commercial value and project economics.

**Other infrastructure**

On other forms of infrastructure, much of the regulation and standard contracting terms should be set out in the ITT.

It is likely that long-term projects will include ‘change in control’ clauses which restrict change in ownership structures. For example, in most sectors there is a restriction on change in control during the construction period but this is often relaxed post construction provided any change in control is not to an ‘Unsuitable Third Party’.

How strict these restrictions are will often depend on the sector. For example, the energy sector has a deep-rooted fear of contractors bringing sub-contractors from cheaper territories, which is often considered to infer there may be quality and performance issues. As a result, the project sponsor will often require strict non-assignment provisions to ensure an assignment cannot be made without its reasonable consent.

Specific restrictions may be included depending on the nature of the project and how revenue for the project parties is being raised and shared. In general, in the UAE most infrastructure projects will use as their contracting base variations of internationally recognized contracts especially AIPN, FIDIC and JCT. In addition, most project financing follows international best practice and often involves the use of Loan Market Association standard agreements. While form is familiar, the details will be specific to the project and the project sponsor.

*Last modified 23 Jan 2020*

**What is the applicable procurement process?**

These issues must be understood on a case-by-case basis.

*Last modified 23 Jan 2020*

**What are the most common forms of funding / investing in energy and infrastructure?**
In the UAE, the principal forms of private sector funding/investment in energy and infrastructure are:

- loans made on a corporate finance basis (balance sheet debt, which may include Shari'a compliant financing);
- loans made on a project-finance basis (to a special purpose project company domiciled either in a UAE free zone or in a traditional offshore jurisdiction such as the Cayman Islands or British Virgin Islands) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bond finance; and
- refinancing of the debt in operational projects.

Restructuring

Enforcement and sanctions

*When can there be regulatory investigations?*

This question needs to be considered from two main perspectives:

- firstly, is the activity itself regulated; and
- secondly, if regulated, by which body or bodies?

While it sounds simple it needs to be established which authority or authorities may regulate a given activity. From a lender's point of view, the UAE Central Bank has published numerous regulations and produced circulars that inform banks as to the necessary capital adequacy ratios and also provided many circulars on internal regulatory controls. Breach of these by the banks could see preventative and punitive action taken against them by the UAE Central Bank.

If a lender, or in a syndicated loan situation, lenders are based in Dubai International Financial Centre (DIFC), then breaches by them of the Dubai Financial Services Authority (DFSA) regulations could see sanctions imposed, or if they exceed the terms of their licenses this can lead also to regulatory problems. The same can be said for lenders based in Abu Dhabi Global Markets (ADGM).

If the lenders have not done sufficient due diligence on their clients and performed their obligations under the Anti-Loney Launderung Law, then this may also constitute a regulatory breach. For instance, they may have been in receipt of funds from either sanctioned countries or blacklisted people and entities.

As well as initial breaches such as those set out above, as the term of infrastructure projects tends to be long and financing arrangements commensurate with the term, the lenders need to ensure that they maintain all regulatory controls throughout the term of the financing. What this looks like in practice will depend on the financing structure and will be different for term credit facilities opposed to revolving credit facilities. In addition to regulatory issues there could be contractual problems for example for failure to be able to make 'repeated warranties' or satisfy conditions subsequent.

*What regulatory penalties may apply?*

This depends on the nature of the transgression but can be anything from fines to suspension and revocation of licenses.

*What criminal penalties may apply?*

There are many circumstances that can lead to criminal penalties for individuals involved in corporate wrongdoing and these have been expanded for directors under the new provisions of the Federal Commercial Companies Law, the Banking Law, the Bankruptcy Law and the Anti-Money Laundering Law.
There are criminal penalties for anyone that has been liable for transgressions under the Foreign Corrupt Practices Act; The UK Bribery Act; Dubai Financial Services Authority anti-money laundering and bribery regulations; as well as people engaged in business practices that may amount to violations of the UAE Penal Code Federal Law No. 3 of 1987. These go from fines to periods of imprisonment for the most serious offences.

Note that if a crime has been committed in either of the Financial Free Zones or Free Zones, the provisions of the UAE Penal Code will prevail.

Last modified 23 Jan 2020

Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

ADVANCE OF LOAN

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan. However, a customer may be required to pay value added tax (VAT) in connection with fees for certain products or services provided by a bank in respect of a loan.

TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN

No stamp, registration, transfer or other similar taxes are payable on the assignment or transfer of a debt under a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Certain security interests created under United Arab Emirates (UAE) law must be registered in order to perfect the security and ensure that it is valid against third parties. For example:

- The grant of any security interest over real estate needs to be properly registered at the land department (in the relevant Emirate where the real estate is located) in order to ensure that the security interest takes effect as a mortgage. A registration fee will typically be payable to the relevant land department and the amount of that fee will depend on the amount secured and/or the value of the property (in accordance with their published fees at the relevant time).
- The grant of any security interest over moveable collateral pursuant to UAE Law No. 20 of 2016 on the Mortgage of Moveable Assets to Secure a Debt is required to be registered at the "Emirates Moveable Collateral Registry", which will attract nominal security registration fees.
- The grant of any security over shares in a UAE company may also need to be registered at the economic department or at the relevant free zone authority (in the relevant Emirate or free zone where that company is registered). A registration fee will also be payable to the relevant economic department or relevant free zone authority (in accordance with their published fees at the relevant time).

Other forms of registration may also be required (or be advisable), depending on the nature of the asset over which security is being taken. Such registrations may also require the payment of fees.

If security needs to be registered, then in certain circumstances it will also be necessary for the security document to be notarized before a notary public in a certified Arabic text (which may also include English, in a dual-text format). This process will involve additional costs in terms of translation charges and notary fees. A notary public will also require proof of authority for signatories, which can involve constitutional documents and resolutions needing to be translated then formally attested and/or legalized before they will be accepted.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or
assignment of a debt security (eg a bond)?

ISSUE OF DEBT SECURITIES

No stamp, registration, transfer or other similar taxes are payable in the UAE on the issue of a debt security (eg a bond). However, it is possible that a securitization structure or an Islamic bond (sukuk) may incur registration or transfer fees depending on the underlying transaction structure (for example, if real estate is involved).

TRANSFER OF BONDS

No stamp, registration, transfer or other similar taxes are payable in the UAE on the transfer or assignment of a debt security (eg a bond).

Are any filings or registrations with the local tax authority required in connection with a loan or a debt security (eg a bond)?

No. It is not necessary to file, register or record a loan or debt instrument with any tax authority, public authority or government agency in the UAE, save that:

- all documents brought before the UAE courts must be in Arabic (or accompanied by a court-certified translation); and
- any applicable court or other fees must be paid upon any court filing of those documents for enforcement purposes in the UAE courts.

However, a bank or any customer operating in the UAE should be registered separately with the FTA for VAT purposes.

Do tax authorities take priority on enforcement?

Preferred creditors (including any amounts owed to the government) will take priority over both ordinary unsecured creditors and secured creditors.

We note that the new United Arab Emirates (UAE) Federal Bankruptcy Law came into effect on 29 December 2016, and this law similarly provides that amounts payable to government authorities are considered to be preferred debts. However (to our knowledge) this law remains relatively untested before the UAE courts and so we are unable to express a view on the scope or application of that new law (or its executive regulations, if any) on preferred creditor status.

Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?
No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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Key contacts

Trevor Butcher
Partner
DLA Piper Middle East LLP
trevor.butcher@dlapiper.com
T: +971 4438 6259
United States

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Capital markets and structured investments

Issuing and investing in debt securities

*Are there any restrictions on issuing debt securities?*

The offering and sale of debt securities is subject to both federal and state securities laws.

For an issuance of debt securities to be permitted under federal law, the issuance must either be registered under the Securities Act of 1933 (Securities Act), or the issuance must be exempt from registration pursuant to an exemption from the registration requirements of the Securities Act.

For certain debt securities, the Trust Indenture Act of 1939 (TIA) will also apply. However, the TIA does not apply to private placements. As a result, only debt securities issued in a registered offering, or subsequently registered in an ‘A/B exchange offer’ will be subject to the TIA. However, indentures for debt securities issued in the high yield market may incorporate by reference all, or a portion, of the TIA, although this is fading as a market practice.

State securities laws (known as ‘blue sky’ laws) regulate both the offering and sale of debt securities as well. However, federal law pre-empts state securities laws for certain types of offerings, particularly registered offerings.

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*What are common issuing methods and types of debt securities?*

Debt securities may be offered either in a registered offering or an unregistered offering which is exempt from registration.

Registered offerings of debt securities are most common in the investment grade context, where many issuers are ‘well-known seasoned issuers’ (WKSIs) and can therefore rely on the filing of an automatically effective registration statement on Form S-3 for the offering. For issuers which are not WKSIs, a registration statement would have to be filed, reviewed by the Securities and Exchange Commission, and only after the review was completed and the registration statement declared effective could the offering commence.

To avoid the delay of the registered offering process, many issuers rely on exemptions from the Securities Act of 1933 (Securities Act) to complete debt securities offerings. Two of the principal exemptions utilized in the debt securities market are Section 4(a)(2) of the Securities Act and Rule 144A issued under the Securities Act.

Section 4(a)(2) exempts from the registration requirements of the Securities Act ‘transactions by an issuer not involving any public offering.’ A broad range of private placements may be structured to rely on the exemption under Section 4(a)(2), including offerings arranged by the issuer directly and offerings where an investment bank acts as a placement agent. Among these are private placements which rely on the safe harbor provided by Regulation D.

Rule 144A provides a resale exemption, which is commonly relied upon in connection with debt securities offerings where an investment
bank acts as an initial purchaser (similar to an underwriter) of the debt securities, then resells the debt securities to the ultimate purchasers. Rule 144A is not an exemption which is available to the issuer for the initial sale to the investment banks (that issuance is usually a Section 4(a)(2) private placement). Securities issued initially in a Rule 144A offering may be subsequently registered under the Securities Act through an 'A/B exchange offer.'

Numerous types of debt securities are offered in US markets. Among the most common are:

- debt securities issued by a corporate issuer, including fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities, Payment-in-Kind (PIK) toggle bonds and high-yield bonds;
- asset-backed securities;
- government securities (federal government bonds and bills, state and local municipal bonds, and bonds issued by government-controlled entities);
- derivative securities such as securities linked to the value of one or more reference assets including shares, commodities, interest rate, currency rate or ndex and credit-linked notes; and
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer).

What are the differences between offering debt securities to institutional / professional or other investors?

The US debt securities market is dominated by institutional investors. Non-institutional investors typically participate in the debt securities market through institutional vehicles such as Exchange Traded Funds (ETFs) and mutual funds.

When is it necessary to prepare a prospectus?

Any registered securities offering under the Securities Act of 1933 will require the preparation and filing of a prospectus. Rule 144A only requires certain limited disclosures to be made to investors, however market practice typically requires substantially the same disclosure in a Rule 144A offering as in a registered securities offering.

What are the main exchanges available?

Debt securities in the US are not typically exchange listed, however all of the major exchanges including the New York Stock Exchange and NASDAQ permit the listing of debt securities.

Is there a private placement market?

Yes, there are multiple private placement markets and sub-markets in the US. Insurance companies invest in private placements on a series of model forms promulgated by the American College of Investment Counsel. On the other hand, the market for high-yield bonds does not have a single dominant documentation standard.

Are there any other notable risks or issues around issuing or investing in debt securities?
Issuing debt securities

An issuer of debt securities will be subject to certain of the anti-fraud protections of the US federal and state securities laws. As a result, an issuer of debt securities may be subject to claims from purchasers based upon the accuracy of the disclosure provided at the time of issuance, which would not apply in a loan transaction.

Investing in debt securities

As a holder of debt securities, the investor is typically not in direct contractual privity with the issuer and must rely upon a trustee to act on behalf of all the holders. As a result, collective action problems can develop, as different investors may have divergent interests and incentives.

Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

A US investment vehicle that is deemed an 'investment company' under US law and cannot rely on an exception or exemption from registration will generally be required to:

- register with the US Securities and Exchange Commission (SEC) under the Investment Company Act of 1940 (ICA); and
- register its public offerings under the Securities Act of 1933 (Securities Act).

If registration is required, the investment company will be subject to various requirements and restrictions, including significant limitations on the ability of the investment company to make carried interest/performance fee payments to its investment manager.

Private investment funds, including hedge funds and debt funds, generally rely on the exceptions to the registration requirement set forth in Sections 3(c)(1) and 3(c)(7) of the ICA.

Section 3(c)(1)

Section 3(c)(1) of the ICA excepts any issuer whose outstanding securities (not including short-term paper) are beneficially owned by 100 persons or fewer and that is not making (and does not propose to make) a public offering of such securities. Where an entity holds more than 10% of the outstanding securities, the numerical cap on investors includes a 'look-through' to the ultimate owners of that entity. In practice, look-through determinations often require a complex law and fact analysis.

Pursuant to Securities Act requirements, an issuer availing itself of the section 3(c)(1) exception can raise an unlimited amount of capital, but all the investors must be sophisticated, and no more than 35 can be sophisticated without also being 'accredited investors.' If a general solicitation for investment is made, all investors must be 'accredited investors.'

Section 3(c)(7)

Section 3(c)(7) of the ICA excepts any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are ‘qualified purchasers’ and that is not making (and does not propose to make) a public offering of such securities. Unlike the section 3(c)(1) exception, the Securities Act does not limit the number of investors, but private funds relying on the section 3(c)(7) exception generally cap investors at 1,999 (or less) in order to avoid registration requirements under the Securities Exchange Act of 1934.

A fund sponsor may be required to register as an Investment Adviser under the Investment Advisers Act of 1940.

What are common fund structures?

Most private funds offered to investors who are subject to US tax are generally limited partnerships or limited liability companies (LLC). US
entities are generally formed under the laws of a US state, rather than under national law. Most private funds are formed in Delaware.

In a master-feeder fund structure, the US feeder is generally a limited partnership or LLC formed in Delaware, while the offshore feeder and the master fund are formed or otherwise organized in a non-US jurisdiction. In most instances, a master fund will be taxed as a US partnership, which may require the filing of an election to that effect with the US Internal Revenue Service.

There are other fund structures common for registered investment companies which are not covered here.

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**What are the differences between offering fund securities to professional / institutional or other investors?**

**Retail funds**

Offerings made to the public must be registered with the Securities and Exchange Commission (SEC) under the Securities Act of 1933 (Securities Act) unless an exemption from registration is available. Importantly, if a fund publicly offers its securities, it loses the ability to rely on the Section 3(c)(1) or 3(c)(7) exemptions from registration under the Investment Company Act of 1940 (ICA). If a fund elects to make a public offering of its securities it must create disclosure materials that comply with the requirements of the Securities Act and obtain SEC review thereof, and observe the rules set forth in the Securities Act and the Securities Exchange Act of 1934 (SEA) relating to the conduct of such offerings. Such a fund generally would also be subject to the provisions of the ICA, including the prohibition on performance-based compensation.

**Institutional/professional funds**

Offerings made to professional or institutional investors are typically made via an exemption from registration under the Securities Act, Regulation D, that permits private offerings to 'accredited investors' with limited oversight by the SEC. 'Accredited investors' include:

- a person whose individual net worth (or joint net worth with that person's spouse) exceeds USD1 million or who had an individual income in excess of USD200,000 in each of the two most recent years or joint income with that person's spouse in excess of USD300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; and
- an entity, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of USD5 million.

Most funds offered to institutional investors are limited to 'qualified purchasers,' and, as discussed above, are offered in private placements. Qualified purchasers include:

- a person who owns at least USD5 million in investments; and
- a person or entity, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis at least USD25 million in investments.

So long as the conditions for the exemption from registration under the Securities Act are met the issuer is not required to obtain SEC review of the disclosure materials prior to the offering or to observe the rules relating to public offerings of securities. However, the fund remains subject to the Securities Act's anti-fraud rules, and the fund must notify the SEC no later than 15 days after the first sale of a security in the private placement.

Fund issuers must also comply with state securities laws to the extent not superseded by applicable federal securities laws. In particular, there may be post-sale filing obligations in states where subscribers for private fund interests reside which should be considered.

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**Are there any other notable risks or issues around establishing and investing in funds?**

**Establishing funds**

A US fund deemed to be an 'investment company' must register with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940 (ICA) unless an exemption from registration is available. Failure to register when required may carry
significant civil and criminal penalties for fund sponsors. In addition, an entity that provides investment advisory or management services to a fund may be required, depending on its aggregate assets under management (AUM), to register with the SEC as an Investment Adviser under the Investment Advisers Act of 1940 (IAA) or with its state securities regulator. The manager of a fund that is not required to register under the ICA may nevertheless be required to register under the IAA.

Prior to accepting investors, the fund must comply with applicable KYC and anti-money laundering rules as well as US tax rules (in particular the Foreign Account Tax Compliance Act), which may require obtaining identification information from potential investors.

In addition, the fund must confirm whether or not potential investors are subject to the Employee Retirement Income Security Act (ERISA), as the presence of such investors in the fund may cause the entire fund to be subject to ERISA’s fiduciary duty rules and other restrictions. The fund and/or its management may also be required to register with the US Commodity Futures Trading Commission under the Commodity Exchange Act or apply for an exemption from registration.

Investing in funds

Potential investors in funds should note the following provisions of the fund's governing documents in the first instance:

- when and under what circumstances investors may be required to indemnify the fund's management or personnel for losses they incur related to the fund, or to return distributions previously made by the fund;
- what rights investors have to remove the fund's management;
- in closed-end funds, the priority of payments for distributable funds (the 'waterfall'), and the portion of such payments to be made as carried interest to the fund sponsor;
- in open-end funds, the methodology of computing performance compensation for the fund sponsor;
- the amount and timing of management fees payable to the fund sponsor;
- in open-end funds, when the investor may redeem/exit the fund;
- the circumstances in which an investor may transfer its interest; and
- the form and jurisdiction of the fund for tax purposes.

Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Funds that intend to market securities to the public in a registered transaction under the Securities Act of 1933 (Securities Act) must comply with the public offering rules set forth therein. Funds that intend to issue securities in private placements not subject to registration under the Securities Act must comply with the marketing restrictions in the relevant exemption. Under the most commonly-used exemption from registration under the Securities Act, Regulation D, sponsors marketing funds in a private placement may not engage in ‘general solicitation’ or ‘general advertising’ relating to the offering. This includes any advertisement, mass mailing, cold calls, article, notice, or other communication published in any newspaper, magazine, or similar media, or broadcast over television or radio, and also any seminar or meeting whose attendees have been invited by any general solicitation or advertising.

Under certain circumstances an issuer using Regulation D may engage in general solicitation or general advertising if the issuer takes additional steps to ensure that all securities sold in the offering are sold to accredited investors. Issuers choosing to market in this fashion must elect to do so and, once they have elected to do so, may not change their election.

Issuers in both registered and unregistered offerings of securities are liable for violations of the anti-fraud provisions of the Securities Exchange Act of 1934 relating to the contents of the disclosure materials provided in connection with the offering.

Are there any restrictions on managing a fund?
A fund registered under the Investment Company Act of 1940 (ICA) must comply with the rules set forth therein, including restrictions on the manner and timing of payments to its manager. Funds using an exemption from registration under the ICA must comply with the terms of that exemption at all times.

If the fund's manager is registered with the Securities and Exchange Commission (SEC) it must meet the duties and obligations imposed by the Investment Advisers Act of 1940 (IAA). Managers exempt from registration must nevertheless obey anti-fraud and other rules in the IAA. All managers whether exempt from registration or not owe fiduciary duties to the fund as a matter of both federal and state law. For example, managers must ordinarily obtain the consent of the investors or a committee of them before causing the fund to enter into a transaction that is subject to a conflict of interest.

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**Entering into derivatives contracts**

*Are there any restrictions on entering into derivatives contracts?*

In the US the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) share jurisdiction over the derivatives market depending on the underlying product that is being traded and whether the transaction is ‘over-the-counter’ (OTC) or traded on an exchange. In addition, banks and financial institutions are subject to the jurisdiction of the Prudential Regulators. Swap dealers and other entities that trade in large volumes need to be registered with the CFTC or the SEC depending on the underlying products being traded. In addition, US rules permit only 'eligible contract participants' (as defined under the Commodity Exchange Act) to enter into OTC derivatives.

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**What are common types of derivatives?**

All of the main types of derivative contract are widely used in the US:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

Products may be 'over-the-counter' (OTC) or exchange traded and entered into for hedging or as part of a trading strategy.

The transactions types that we see most often relate to interest rate or currency hedging such as FX forwards, interest swaps or interest rate caps. The needs of the relevant entity drive the underlying type of hedging. A power company client may have commodity hedging needs whereas a manufacturer may be concerned only with hedging the interest rate on its debt.

Common products that we see are commodity derivatives, equity derivatives, interest rate derivatives, currency derivatives, credit derivatives and insurance-linked derivatives.

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**Are there any other notable risks or issues around entering into derivatives contracts?**

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. As a result, the derivatives market has seen, and continues to see, the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

There are business risks that need to be considered – although hedging is seen as a tool to minimize risk, an entity needs to consider whether the derivatives product is appropriate and assess the down-side risk. In most cases, a derivatives trading relationship requires the posting of margin; entities should consider whether they are in a position to post margin and, if so, the types of margin that are
available as in some instances applicable rules limit the types of margin that may be posted. In addition, margin that is posted to a counterparty may be at risk and an entity may want to consider posting margin to a third-party custodian instead of directly to its counterparty.

**Regulatory compliance**

Rules promulgated by the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) pursuant to the Dodd-Frank Act may impose a compliance burden such as record keeping or trade reporting. In addition, European regulations or the regulations of another jurisdiction may be relevant depending on the location of the parties. As a result of new global regulations that affect the derivatives market, an entity may be required by its counterparty to sign up to certain industry protocols or provide information.

**Operations**

Derivatives trading often involves the exchange of margin and an entity must be operationally capable of posting, calling for and calculating margin. In addition, the entity needs to have processes and systems in place to manage trading activity and the related documentation.

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**Debt finance**

**Lending and borrowing**

*Are there any restrictions on lending and borrowing?*

**Lending**

The amount of regulation a lender faces will depend on the type of product (consumer or commercial) and the type of collateral securing the product (real estate or non-real estate). Consumer loans are more heavily regulated than commercial loans, with consumer loans secured by real estate being the most heavily regulated on both the federal and state level and unsecured commercial loans being the least regulated. That being said, it is unlikely for any credit product offered in the US to be completely unregulated in all states and jurisdictions.

Below are some general restrictions on lending.

**PROHIBITION ON UNSAFE AND UNSOUND BANKING PRACTICES**

The Federal Deposit Insurance Act (FDI Act) prohibits federally and state-chartered banks and thrift institutions from engaging in unsafe and unsound banking practices, including those relating to banks’ lending activities. Regulators can impose corrective measures, including cease-and-desist orders or termination of the bank’s deposit insurance coverage for a bank engaging in any unsafe or unsound banking practices.

**CAPPING OF INTEREST RATES**

State usury laws, which may apply to both federally and state-chartered banks, impose limitations on the interest rates that banks may charge for consumer and commercial loans.

**LIMITS ON LOANS TO ONE BORROWER**

Federal law caps the amount of credit that national banks are permitted to extend to one borrower or to a group of related borrowers, subject to specific exceptions which are tailored to the nature and type of loan. Some states have comparable limitations.

**RESTRICTIONS ON LENDING TO AFFILIATES**

Federal law restricts lending and other extensions of credit by a bank directly or indirectly to its affiliates by setting quantitative limitations on a bank’s transactions with any single affiliate, and with all affiliates combined, and by setting forth collateral requirements for certain
RESTRICTIONS ON LENDING TO INSIDERS

Loan terms to insiders are closely regulated and some transactions can be prohibited entirely. Additional requirements for loans to executive officers and directors exist.

ANTI-TYING RULES

The Bank Holding Company Act (BHC Act) prohibits banks from requiring their customers to obtain any product or service, including non-bank products or services, as a condition to the extension of credit. Certain safe harbors exist.

PROHIBITIONS ON DISCRIMINATION

The Equal Credit Opportunity Act (ECOA) applies to all creditors and prohibits a lender from discriminating on the basis of a protected characteristic (race, color, religion, national origin, sex, marital status, age, the receipt of public assistance).

Below are some consumer-specific restrictions on lending.

CONSUMER LENDING DISCLOSURE OBLIGATIONS

Truth in Lending Act (TILA) and Regulation Z require certain disclosures to be made when providing consumer credit. The ECOA requires notification disclosures to be provided to denied applicants of consumer credit.

PROHIBITIONS ON UNFAIR, DECEPTIVE, OR ABUSIVE ACTS OR PRACTICES (UDAAPS) IN CONSUMER LENDING

The Dodd-Frank Act prohibits UDAAPs. For generic examples of what may be considered a UDAAP please consider the Consumer Financial Protection Bureau bulletin dated 10 July 2013.

ADDITIONAL PROHIBITIONS ON DISCRIMINATION

The Fair Housing Act prohibits discrimination on the basis of race, color, national origin, religion, sex, familial status, and handicap in all aspects of residential real estate related transactions, including but not limited to: (1) making loans to buy, build, repair, or improve a dwelling; (2) purchasing real estate loans; (3) selling, brokering or appraising residential real estate; or (4) selling or renting a dwelling.

RESIDENTIAL MORTGAGE REQUIREMENTS

Residential mortgage origination, selling/purchasing, and servicing is closely regulated on both a federal and state level. Numerous restrictions, standards, and disclosure requirements specific to residential mortgages exist in this highly regulated space.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

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What are common lending structures?

Lending in the US can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility), a club basis (a small group of multiple lenders each providing parts of the overall facility) or syndicated basis (a larger group of multiple lenders each providing parts of the overall facility).

Loans can be secured or unsecured. Assets of a debtor can have multiple security interests attached thereto and such security interests are usually allocated among secured parties in respect of priority and other similar rights pursuant to an intercreditor agreement. A first-lien/second-lien loan can be combined into one unitranche loan. In this structure, the lenders enter into an agreement among
lenders outside of the credit agreement with the borrower.

Club and syndicated facilities by their nature involve more parties (such as agents which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, e.g. acquisition financing, dividend recapitalizations, working capital loans or letter of credit facilities.

**Loan durations**

The duration of a loan may include:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- a swingline loan, provided on a short-term basis to solve short-term cash flow issues; or
- a bridge loan, provided for up to a year and intended to bridge the gap until another financing source is available.

**Loan security**

A loan can either be secured, unsecured or guaranteed. For more information, see [Giving and taking guarantees and security – common types](#).

**Loan commitment**

Lenders are obligated to provide the loan if certain conditions are fulfilled.

A credit agreement may also include an uncommitted incremental facility or an accordion, which allow the borrower to increase the commitments of the existing lenders or bring new lenders into the facility. The lenders do not commit upfront to providing additional loans.

**Loan repayment**

Typically, a term loan is repayable on an amortizing basis (in instalments over the life of the loan) or is repayable in full at maturity. Revolving loans may be reborrowed and repaid throughout the life of the facility.

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**What are the differences between lending to institutional / professional or other borrowers?**

Federal agencies, such as the US Consumer Financial Protection Bureau, regulate lending to consumers and in the context of residential real estate loans. Lenders in the context of commercial real estate loans should also consider zoning laws and environmental regulations.

For more information, see [Lending and borrowing – restrictions](#).

*Last modified 24 Jan 2020*

**Do the laws recognize the principles of agency and trusts?**

Yes, both principles are recognized as a matter of US law.

For instance, it is common to appoint an agent in connection with a loan or a trustee in connection with a bond. The agent or trustee, as applicable, may act on behalf of the lenders or secured parties or hold rights and other assets on for such lenders or secured parties.
Are there any other notable risks or issues around lending?

Generally

Federal and state laws prohibit lenders from charging an unreasonably high interest rate or other unreasonable fees. Lenders who violate usury laws may incur civil or criminal penalties.

Standard form documentation

Credit agreements in the US are typically based on the agent's or lead lender's standard form. This may incorporate language recommended by the Loan Syndications and Trading Association, but there is no standard form documentation.

Are there any other notable risks or issues around borrowing?

There are no other notable risks or issues around borrowing to be raised further to those outlined in preceding sections.

Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Below are some of the key areas affecting the giving of guarantees and security.

Capacity

It is important to check the law of the state in which the company is organized, as well as the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative.

Consideration

Many state statutes require that the guarantee be in furtherance of the company's purpose and that the company receive a benefit in exchange for providing such guarantee. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution. Some state statutes also provide a safe harbor if the company and borrower are part of the same corporate group.

Insolvency

Guarantees and grants of security may be at risk of being set aside under US bankruptcy laws if the guarantee or security was granted by a company that was insolvent at the time of such grant and the company received less than reasonably equivalent value for the guarantee. Guarantees and security may also be challenged on other grounds relating to insolvency.

What are common types of guarantees and security?

Common forms of guarantees
Guarantees can take a number of forms. A particular distinction worth remembering is between a guarantee of payment and a guarantee of collection.

Under a guarantee of payment, the guarantor is obligated to repay the lenders immediately upon default of the borrower. The lenders are not required to first take any action against the borrower. Guarantees of payment are customary in the US.

Under a guarantee of collection, the lenders must first exhaust all remedies against the borrower before they may make a claim under the guarantee. The lenders are only entitled to the shortfall not paid by the borrower.

**Common forms of security**

Under US law, personal property, fixtures, general intangibles and other certain types of collateral are governed by the Uniform Commercial Code (UCC) as adopted in the borrower's state of organization. Other types of collateral, including mortgages and motor vehicles, are governed by applicable state or federal laws, instead of or in addition to the UCC.

Under US law it is possible to grant security over all or a portion of the assets of a US borrower or guarantor.

**Are there any other notable risks or issues around giving and taking guarantees and security?**

**Giving or taking guarantees**

Guarantees are typically considered secondary, and not primary, obligations.

Many legal defenses are available to guarantors which may invalidate the guarantor's obligations under the guarantee, including the invalidity of the underlying credit agreement or a change to the corporate structure of the borrower. However, in most cases, the lenders require the guarantor to waive these defenses, and doing so is typically permitted under applicable US law.

US state law typically requires that a guarantee be in furtherance of the guarantor's purpose and that the guarantor receive a benefit in exchange for providing such guarantee. This may be achieved if the company and borrower are part of the same corporate group.

**Giving or taking security**

A security interest is created and attaches to the company's property when the lender extends credit to the borrower and the borrower delivers to the lender a written agreement granting the security interest and describing the property.

Once created, the security interest needs to be properly perfected before it is valid against third parties. Perfection formalities are governed by the Uniform Commercial Code (UCC) as adopted in the borrower's state of organization and, with respect to real estate, by the real estate law of the state where real property is located. Perfection formalities can range from having the secured asset delivered to the security holder, filing a financing statement or mortgage or entering into a control agreement. Under the UCC, a lender who properly files a financing statement first typically has priority over other lenders, with certain exceptions.

Security documents granting a security interest in personal property collateral generally do not need to be notarized, but notarization may be required for real property in certain states.

There may be negative tax consequences to a US borrower if the loan is secured by all of the assets of its non-US subsidiary that is considered a 'controlled foreign corporation.'
What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

**FEDERAL**

Federal Deposit Insurance Act (FDI Act)

Federal Reserve Act

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

Volcker Rule (implementing section 619 of the Dodd-Frank Act)

Regulation W (implementing sections 23A and 23B of the Federal Reserve Act pertaining to restrictions on lending to affiliates)

12 US Code (USC) section 84 and 12 Code of Federal Regulations (CFR) section 32 (restrictions on lending limits)

Regulation O (restrictions on lending to insiders)

Bank Holding Company Act (BHC Act) (anti-tying rules)

Equal Credit Opportunity Act (ECOA) (fair lending)

Regulation B (implementing the ECOA)

Bank Secrecy Act

Securities Act of 1933 (Securities Act) and the Securities and Exchange Commission (SEC) rules thereunder

Securities Exchange Act of 1934 (SEA) and the SEC rules thereunder

Investment Advisers Act of 1940 (IAA) and the SEC rules thereunder

Investment Company Act of 1940 (ICA) and the SEC rules thereunder

**STATE**

Individual state laws and related state regulations apply.

**Consumer credit**

**FEDERAL**

Truth in Lending Act (TILA)

Regulation Z (implementing TILA)

**STATE**

Individual state laws and related state regulations, including licensing and compliance regimes apply.

**Mortgages**

**FEDERAL**

Fair Housing Act

Home Mortgage Disclosure Act (HMDA)

Regulation C (implementing the HMDA)
Truth in Lending Act (TILA)

Regulation Z (implementing TILA)

Real Estate Settlement Procedures Act (RESPA)

Regulation X (implementing RESPA)

TILA/RESPA Integrated Disclosure Rule (TRID)

**STATE**

Individual state laws and related state regulations, including licensing and compliance regimes apply.

**Securities**

BROKER-DEALERS/INVESTMENT ADVISERS (AS DEFINED IN THE INVESTMENT ADVISERS ACT OF 1940)

*Federal*

Securities Act and the SEC rules thereunder

SEA and the SEC rules thereunder

IAA and the SEC rules thereunder

ICA and the SEC rules thereunder

*State*

Individual State Securities ('blue sky') laws and related state regulations apply.

**BROKER-DEALERS ONLY**

Self-regulatory organizations

Financial Industry Regulatory Authority (FINRA) Rules

National Securities Exchange Rules (e.g. New York Stock Exchange, NASDAQ Stock Market)

Federal Reserve Board of Governors Margin Rules (Regulation T)

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**Regulatory authorization**

**Who are the regulators?**

**Lending**

**FEDERAL**

The Office of the Comptroller of the Currency (OCC) is an independent bureau within the US Treasury Department that charters, regulates, and supervises all national banks and thrift institutions and the federal branches and agencies of foreign banks in the US.

The Federal Deposit Insurance Corporation (FDIC) is a US government corporation that provides deposit insurance to depositors in US banks. It also examines and supervises certain financial institutions for safety and soundness, performs certain consumer-protection functions, and manages receiverships of failed banks.

The Federal Reserve Board of Governors (Federal Reserve) is the main governing body of the Federal Reserve System and is charged with
overseeing the Federal Reserve Banks and helping to implement monetary policy in the US.

The Consumer Financial Protection Bureau (CFPB) is an independent US government agency that enforces consumer protection laws and regulations specific to the US financial sector. Its jurisdiction includes banks, credit unions, securities firms, payday lenders, mortgage-servicing operations, debt collectors, and other financial companies operating in the US.

The Federal Trade Commission (FTC) is an independent US government agency that enforces consumer protection laws and regulations.

The Financial Crimes Enforcement Network (FinCEN) is a bureau of the US Treasury Department that collects and analyzes information about financial transactions in order to combat domestic and international money laundering, terrorist financing, and other financial crimes.

STATE

State regulatory agencies regulate state-chartered banks and certain non-affiliates of federally chartered banks, as well as non-bank lenders.

Securities

FEDERAL

The US Securities and Exchange Commission (SEC) is the primary regulator of the US securities markets and oversees the key participants in the securities world, including securities exchanges, brokers and dealers, investment advisors and mutual funds.

The Financial Industry Regulatory Authority (FINRA) is an independent, not-for-profit organization authorized by Congress to protect investors and market integrity through regulation of broker-dealers.

National Securities Exchanges (acting in the role of self-regulatory organizations) are securities exchanges that have registered with the SEC under section 6 of the Securities Exchange Act of 1934.

The US Commodity Futures Trading Commission (CFTC) is an independent US government agency that polices the derivatives markets and futures and swaps markets to lower the risk to the public.

STATE

State securities regulators enforce ‘blue sky’ laws, which cover many of the same activities the SEC regulates, but are confined to securities sold or persons who sell them within each state.

Last modified 24 Jan 2020

What are the authorization requirements and process?

Lending

The need for authorization to offer credit products varies depending on the type of product (consumer or commercial) and the type of collateral securing the product (real estate or non-real estate). Most product offerings require prior authorization. Certain entities (e.g. savings associations, credit unions, and banks) are authorized to lend on a national basis. Other non-bank lenders are required to obtain individual state authorization, which generally permits lending to borrowers located only in that state.

In most cases, the process for obtaining the requisite authorization is initiated with an application that typically includes identification of control parties and management, disclosure of any negative civil, criminal, and regulatory history, meeting capital and/or surety bond requirements, providing financial statements, business plans, and organizational charts, and related compliance obligations as discussed below.

Broker-dealers

Obligations include:

- registration of the entity with the Securities and Exchange Commission (SEC) as a broker-dealer;
• registration of the entity in each state in which it 'does business' (by having a physical presence in the state or by engaging in business with persons inside the state from outside the state);

• membership in a registered national securities association, i.e. the Financial Industry Regulatory Authority (FINRA) – the only exception is for broker-dealers that do no public customer business and only engage in activities on a national securities exchange of which they are a member, who may in some cases avoid FINRA membership;

• registration with FINRA of each individual engaged in the broker-dealer's securities business (except for clerical and administrative personnel) and with each state in which the individual does business – as with broker-dealer firms, registration by individuals working for firms whose only business is on the floor of an exchange may in some cases be done through that exchange;

• registration of each individual only after successful completion of one or more proficiency examinations relevant to the person's business; and

• fees and charges generally for each of the above items.

**Investment Advisers (as defined in the Investment Advisers Act of 1940)**

Obligations include:

• registration of the entity with the SEC as an 'Investment Adviser' (as defined in the Investment Advisers Act of 1940); or

• for certain small Investment Advisers (determined by assets under management), registration instead with the particular state in which they do business.

There are no self-regulatory organizations for investment advisers. Investment Adviser personnel do not have to register with the SEC; however, they may be required to register with certain states in which they do business and take a proficiency exam in connection therewith.

**What are the main ongoing compliance requirements?**

**Lending**

Compliance requirements vary depending on the type of lender (bank or non-bank), the regulatory agency from which that entity seeks authorization, and the products being offered. Nevertheless, common requirements include periodic financial reports to the regulator, assessment of management, compliance with Know your Customer (KYC) and anti-money laundering (AML) rules and regulations, compliance with applicable interest rate caps, fee limitations, disclosure obligations, and limitations or prohibitions on referral fees.

**Broker-dealers**

Specific requirements include:

• continually updating relevant information provided at the time of registration – for both the firm and its registered individuals;

• supervision of each business activity and each registered individual by a qualified (by examination) supervisor/principal pursuant to detailed written supervisory procedures;

• annual review and certification of adequacy of the broker-dealer’s supervisory structure and procedures by the broker-dealer’s CEO or an equivalent senior officer;

• regular (annual or bi-annual) regulatory examinations by the Securities and Exchange Commission (SEC), Financial Industry Regulatory Authority (FINRA) and, in some cases, state regulators;

• detailed procedures for opening customer accounts including obtaining detailed background and financial information for each customer, including required AML-related information;

• maintenance of accurate books and records relating to each part of the business, including transactions, finances, and customer/client information in prescribed formats and for prescribed periods;
• requirements for protection of confidential customer/client information and material non-public information;
• supervision, review and retention of all communications with the public (including all electronic communications);
• detailed minimum net capital requirements and regular reporting of net capital calculations and immediate notification and/or cessation of business requirements if capital falls below prescribed amounts;
• detailed requirements for protecting customer securities and funds;
• requirement to establish, maintain and enforce detailed cybersecurity, business continuity and disaster recovery procedures; and
• continuing education requirements for each registered individual.

Investment Advisers (as defined in the Investment Advisers Act of 1940)

Specific requirements include:
• continually updating relevant information provided at the time of registration;
• supervision of each business activity and each employee pursuant to detailed written compliance procedures;
• annual review of the Investment Advisers' written policies and procedures designed to prevent violations of the Investment Advisers Act of 1940 (IAA) and the rules thereunder;
• periodic regulatory examinations by the SEC and/or state regulators;
• developing and maintaining procedures with respect to political contributions;
• maintenance of accurate books and records relating to each part of the business;
• requirements for protection of confidential customer/client information and material non-public information;
• requirement to deliver a brochure and one or more brochure supplements to each client or prospective client that contains all information required by Part 2 of SEC Form ADV (a uniform form used by Investment Advisers to register with both the SEC and state securities authorities);
• requirements for prevention of misuse of material non-public information;
• requirement to establish, maintain and enforce a detailed code of ethics;
• requirement to file Form PF (reporting form for ‘investment advisers to private funds’), providing data intended to facilitate monitoring of systemic risk private fund (applies to all private funds including private equity funds, hedge funds and liquidity funds);
• requirement to establish, maintain and enforce detailed cybersecurity, business continuity and disaster recovery procedures;
• compliance with rules relating to advertising and marketing materials; and
• compliance with requirements relating to custody of client assets.

What are the penalties for failure to be authorized?

Lending

Penalties for violations of law can include cease and desist orders, civil monetary fines, enforcement actions, prescriptive orders, and even imprisonment depending on the regulator and the nature of the infraction. In some cases, if an entity is lending without authorization to do so, the loan will be considered void and unenforceable or the lender will be enjoined from collecting interest on the loan.

Securities

Examples of penalties for failure to obtain authorization are, for broker-dealers:
• cease and desist orders;
• monetary fines and penalties;
• disgorgement of fees, compensation or profits;
• potential rescission of any transaction intermediated by an unlicensed entity or person; and
• willful violations of the Securities Exchange Act of 1934 (SEA) may be prosecuted as criminal violations, with large fines to entities and potential incarceration for individuals.

And for Investment Advisers (as defined in the Investment Advisers Act of 1940):

• cease and desist orders;
• monetary fines and penalties;
• injunctions; and
• willful violations of the Investment Advisers Act of 1940 (IAA) may be prosecuted as criminal violations, with large fines to entities and potential incarceration for individuals.

Regulated activities

What finance and investment activities require authorization?

Lending

It will depend on the jurisdiction in which the products are being offered.

Broker-dealers

Any activity involving the offer or sale of securities, or the solicitation of an offer to purchase securities requires registration, including retail and institutional brokerage, proprietary trading and market making, and M&A activity that involves transactions in securities (as opposed to pure asset sales).

Investment Advisers (as defined in the Investment Advisers Act of 1940)

Engaging, for compensation, in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

Are there any possible exemptions?

Lending

It will depend on the jurisdiction in which the products are being offered.

Broker-dealers

FEDERAL

There are certain very limited exemptions from the broker-dealer registration requirements, including:

• exemptions for officers and employees of issuers engaged in the offer and/or sale of their employers’ own securities (subject to strict limitations including compensation restrictions);
• exemptions for certain non-US broker-dealers operating from outside the US, engaging in certain limited activities with certain institutional investors (in most cases, the participation of a US registered broker-dealer in key parts of the process is required); and

• other exemptions provided from time-to-time by the Securities and Exchange Commission (SEC) through 'no-action' letters and similar relief.

STATE

A number of states have exemptions from registrations for broker-dealers and their individual personnel that engage in limited activities from outside the state with certain types of investors (in most cases institutional investors only) in the state. The existence, terms, and conditions of each state's exemption may differ.

Investment Advisers (as defined in the Investment Advisers Act of 1940)

The following Investment Advisers are exempt from authorization requirements:

• any Investment Adviser (other than an Investment Adviser who acts as an Investment Adviser to any private fund), all of whose clients are residents of the State within which the Investment Adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;

• any Investment Adviser whose only clients are insurance companies;

• any Investment Adviser that is a private fund advisor, i.e. an advisor solely to private funds with less than USD150 million in assets under management in the US;

• any Investment Adviser that is a venture capital advisor;

• any Investment Adviser that is a charitable organization as defined in the Investment Company Act of 1940 (ICA), or is a trustee, director, officer, employee, or volunteer of such a charitable organization acting within the scope of such person's employment or duties with such organization, whose advice, analyses, or reports are provided only to one or more of the following:

  • any such charitable organization;

  • a fund that is excluded from the definition of investment company under the ICA; or

  • a trust or other donative instrument, or the trustees, administrators, settlors (or potential settlors), or beneficiaries of any such trust or other instrument;

• any plan described in section 414(e) of the US Internal Revenue Code of 1986 (Revenue Code), any person or entity eligible to establish and maintain such a plan under the Revenue Code, or any trustee, director, officer, employee of or volunteer for any such plan or person, if such person or entity, acting in such capacity, provides investment advice exclusively to, or with respect to, any plan, person, or entity or any company, account, or fund that is excluded from the definition of an investment company under section 3(c)(14) of the ICA;

• any Investment Adviser that is registered with the Commodity Futures Trading Commission (CFTC) as a commodity trading advisor whose business does not consist primarily of acting as an Investment Adviser, as defined in the Investment Advisers Act of 1940 (IAA), and that does not act as an Investment Adviser to certain registered investment companies or business development companies;

• any Investment Adviser that is registered with the CFTC as a commodity trading advisor and advises a private fund, provided that, if after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, the business of the advisor should become predominately the provision of securities-related advice, then such advisor must register; and

• any Investment Adviser, other than any entity that has elected to be regulated or is regulated as a business development company, who solely advises certain small business investment companies.

Do any exchange controls or other restrictions on payments apply?

Securities transactions effected by US broker-dealers, including transactions in non-US securities, must be reported by the executing
broker-dealer to Financial Industry Regulatory Authority (FINRA). Any transaction reported to FINRA must be reported in US dollars, regardless of the currency in which the transaction occurred. The methodology employed by the broker-dealer for currency conversion is left to the broker-dealer; however, the methodology must be reasonable and the broker-dealer must document its practice and employ the same method consistently.

Foreign exchange transactions are generally effected through futures commission merchants subject to the oversight of the Commodity Futures Trading Commission (CFTC) pursuant to the US Commodity Exchange Act. However, forex securities transactions effected by securities broker-dealers are subject to FINRA oversight. In an effort to protect retail investors, FINRA from time to time issues cautionary bulletins to investors about the risks of forex transactions and in 2009 proposed to limit the leverage ratio that a FINRA-member broker-dealer could offer a retail forex customer. The proposed rule was later withdrawn.

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What are the rules around financial promotions?

Rules

Offers of securities and other financial products are subject to detailed requirements and restrictions imposed by the Securities Act of 1933, Securities Exchange Act of 1934 (SEA), Investment Advisers Act of 1940 (IAA) and Investment Company Act of 1940 (ICA), as well as relevant Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) rules and regulations thereunder, including without limitation:

- registration requirements for offered securities;
- registration and licensing requirements for persons involved in such activities;
- requirements with respect to the content of prospectuses, offering memoranda and other documents;
- supervision and retention requirements; and
- general antifraud prohibitions.

Offers of financial services are likewise subject to detailed requirements imposed by the foregoing statutes, rules and regulations, including:

- detailed requirements for content, retention and supervision of communications with clients/customers and potential clients/customers;
- advertising regulations;
- requirements for providing investment research; and
- general antifraud prohibitions.

Exemptions

The relevant requirements and restrictions imposed by the foregoing statutes, rules and regulations include various exemptions and exceptions, which generally are based on the nature of the offered products or services, the intended target audience, the type of communication and specific content thereof, and a number of other factors.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Lending
It will depend on the nature and purpose of the intended activities and any applicable laws, regulations, or jurisdictional constraints.

**Securities generally**

Most broker-dealers and Investment Advisers (as defined in the Investment Advisers Act of 1940) are either corporations or limited liability companies (LLCs). Certain firms may operate as general or limited partnerships but this is not common today.

**Funds**

Funds are often established as LLCs or limited partnerships although other structures are used depending on taxation and regulatory analysis, amongst other things.

Is it possible to conduct lending or investment business through a branch or establishment?

**Lending**

Generally, yes, subject to laws and regulations regarding branches, which vary depending on the regulator and jurisdiction.

**Securities**

Broker-dealers commonly operate through branch offices and, in some cases, satellite offices not treated as branch offices (including certain home offices of individual registered representatives of broker-dealers). Each such office is subject to detailed rules regarding staffing, supervision, oversight by home office, recordkeeping, signage and other matters.

**FinTech**

**FinTech products and uses**

*What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

**Online lending (e.g. peer-to-peer funding platforms and marketplace lending)**

A variety of online lending and similar platforms currently exist in the US. While each of these platforms have distinct business models and focus on different markets and asset classes, they can most easily be categorized as either 'balance sheet lenders' (i.e. those that invest their own money in the assets they originate) or 'peer-to-peer (P2P) lenders' (i.e. those that create and manage a platform on which investors in credit products can provide credit to either individuals or businesses seeking credit).

Balance sheet lenders make money the old-fashioned way – by earning yield on the products they originate, which after deducting losses, cost of funds and administrative costs, should result in a profit.

P2P lenders on the other hand, typically do not take balance sheet risk and instead earn a fee for every transaction executed on the platform. Both models use technology extensively and in novel ways for both customer acquisition, underwriting and portfolio management. Also, online lenders generally do not have a bank charter, and thus are unable to take deposits to fund their business (although some online lenders recently applied for an Federal Deposit Insurance Corporation (FDIC)-insured industrial loan company charter).

Online lenders address most forms of traditional bank funding products. Recently, products have included:
- credit cards;
- consumer loans (secured and unsecured);
- merchant cash advances;
- student lending products;
- small business lending;
- residential property and commercial property mortgage lending; and
- multiple forms of factoring.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support this sector.

**HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?**

Balance sheet online lenders, without a bank charter, raise debt and equity from both private and public sources to finance their asset originations, and also establish whole-loan sale programs whereby institutional investors purchase loans shortly after origination (thus earning the originator an immediate premium on the asset sold and relieving the originator from the burden of financing the asset through maturity). As these balance sheet online lenders are becoming more mature, they are also accessing funds via the traditional securitization markets, in both rated and unrated deals.

P2P lenders, on the other hand, originally conceived of a model whereby the ‘investor side’ of the platform would provide all necessary financing. However, as the P2P models have evolved, many platforms have become more reliant on the stability and cost-effectiveness of institutional financing, often executed through committed whole-loan sale programs whereby the institutional investors agree to buy newly-originated assets meeting certain specified criteria either on a one-off basis or on a periodic schedule. These investors then leverage the assets themselves in multiple ways, including with traditional warehouse and term financing and through the securitization markets.

**ISSUES FOR STARTUP ONLINE LENDERS**

Most startup online lenders initially raise equity to establish the business and fund initial originations, and thereafter raise private debt financing as they continue to build the business. Most of these debt facilities are structured as special purpose vehicle (SPV) financings, whereby the newly-originated asset is sold to the SPV (a subsidiary of the originator) and then the lender makes a loan to the SPV at a pre-agreed percentage of the principal balance of the asset (for instance, 85%). Thereafter, the SPV is required to maintain the ‘borrowing base’ at all times, lest it default on its obligations to the lender. First facilities tend to be quite expensive and advantageous to the lenders; but as the originator grows, and its performance track record increases, the cost of funding normally drops over successive debt facilities.

Depending on the model used, the particular asset class, and whether the online lender partners with a bank, the lender must also consider any license or authorization to lend that applies. Such requirements are driven by the state or location of the borrower in most cases, which unfortunately dictates a fairly extensive multi-state assessment for online lenders seeking to provide credit on a national basis.

**Blockchain, smart contracts and cryptocurrencies**

**WHAT IS BLOCKCHAIN?**

Blockchain is a distributed ledger technology in which data is recorded on a P2P network, using pre-agreed consensus algorithms to process changes in the data. Data is stored in ‘blocks’ that, as transactions are processed, connect to form a ‘chain’.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by a consensus of the users in the network following a verification process that requires significant effort and expense, which makes it practically impossible to insert fake transactions into a block.

**WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)?**
Developments in blockchain are also providing an ability to transfer and rely on instructions set forth in so-called ‘smart contracts’. Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so called ‘Oracles’. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of the transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

**WHAT IS A CRYPTOCURRENCY?**

Cryptocurrency is the common name given to digital representations of value. Unlike fiat currencies, cryptocurrencies are not created or sanctioned or backed by any governmental entity. Instead, they are usually issued by entities as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin, although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether and litecoin. Cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging them.

**Initial coin offerings and token-based products**

**WHAT IS AN INITIAL COIN OFFERING (ICO)?**

ICOs are offerings of digital currency (tokens) for sale to the public or to a set of users, often as a means of raising funds for a new blockchain or cryptocurrency venture. ICOs vary in structure and purpose. Some ICOs offer tokens to customers or suppliers as a form of loyalty program, while others offer network users access to the network or purchasing power as to the issuer's business. It is essential to examine the legal and regulatory basis for any ICO, as tokens may constitute securities, commodities, money transmission devices, or otherwise raise legal concerns.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

The Securities and Exchange Commission and several other governmental authorities in the US are actively monitoring ICOs.

**Artificial intelligence and robo advisory systems**

Automated financial advice tools, also known as ‘robo advisors’, are software tools driven by artificial intelligence (AI) that provide a variety of investment advisory services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Robo advisors are particularly important to investment advisors and broker-dealers, including those serving younger clientele. The Financial Industry Regulatory Authority (FINRA) reported in December 2016 that 38% of investors between the ages of 18 and 34 have used robo advisors, although their popularity has been expanding among all age groups and classes of investors.

Robo advisors in the US must comply with the securities laws applicable to any other type of investment advisor, including state or federal registration obligations. These authorities have published various guidance concerning robo advisors, both for the benefit of investment advisors offering robo-advisor services and their clients. Key considerations relevant to anyone involved in this space include:

- decreased human involvement;
- the information provided to create recommendations;
- the approaches (from style to products to risk profile) that the robo advisors use; and
- the fees charged.
Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

In the US, financial services related activities are regulated under a variety of federal and state laws.

FEDERAL

At the federal level, the key banking regulators are the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), and the Office of Comptroller of the Currency (OCC), with the National Credit Union Administration (NCUA) regulating credit unions.

The Securities and Exchange (SEC) commission regulates securities issuers, investment companies, broker-dealers, investment advisors, and certain others involved in the securities industry.

The Commodity Futures Trading Commission (CFTC) regulates swap execution facilities, derivatives clearing organizations, designated contract markets, swap data repositories, swap dealers, futures commission merchants, commodity pool operators, and other entities.

The Financial Crimes Enforcement Network (FinCEN) of the US Department of the Treasury regulates money services businesses, including currency dealers, check cashers, money transmitters, and others.

STATE

In addition, most US states have separate laws that regulate these industries, as well as other ancillary financial services such as various types of consumer lending or loan brokering activities. Notably, the insurance industry is regulated at the state level.

Regulation of online lenders

ONLINE LENDERS

Online lenders are regulated by all 50 states and, in some capacities, at the federal level. Depending on the state and the asset class, licenses could be required for lending, collection/servicing or money transmission services.

Startup online lenders should consider the cost of these compliance activities as they conduct their initial equity raise(s), as the ability to raise subsequent debt financing will depend upon the prospective lenders being reasonably satisfied that the originator is in compliance with all applicable lending and other laws and has all necessary licenses.

Regulation of money service businesses

A ‘money services business’ (MSB) generally includes any person doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities in the US:

- currency dealer or exchanger;
- check casher;
- issuer of traveler's checks, money orders or stored value;
- seller or redeemer of traveler's checks, money orders or stored value; or
money transmitter.

At the federal level, an activity threshold of greater than USD1,000 per person per day applies to the first four categories, but no activity threshold applies to money transmitters. Activities performed by banks or SEC or CFTC registrants are excluded from MSB registration. In addition, there is a limited exemption for persons that sell goods or provide services (other than money transmission services) and only transmit funds as an integral part of that sale of goods or provision of services.

An MSB must register with FinCEN. Among other things, MSBs must also implement a risk-based compliance program designed to detect and prevent money laundering, terrorist financing, and other illicit activities. In addition, most US states require licenses to perform these activities in their state, which can take more time and entail more resources to obtain. Notably, exemptions available at the federal level do not always translate to exemptions from state licensure.

FinCEN has stated that certain virtual currencies may trigger money transmission regulation. While users of virtual currencies are not money transmitters, those who issue virtual currency or put it into circulation and have the authority to redeem or withdraw it from circulation may be regulated as an ‘administrator’. In addition, if a business exchanges virtual currency for fiat currency or other virtual currency, the business may be regulated as an ‘exchanger’.

Application of data protection and consumer laws

US privacy law is a complex patchwork of privacy laws and regulations addressing specific industries, communications media, or marketing methods, supplemented by a backdrop of federal and state prohibitions against unfair or deceptive business practices and state laws that specifically address privacy and security of personal information.

The US has not adopted a comprehensive federal privacy and data security law akin to the UK Data Protection Act of 1998 and related laws. Instead, the US has implemented a sectoral approach to data privacy, promulgating regulations in areas that it deems to be of specific concern, including:

- financial data;
- credit data;
- background checks;
- health information;
- telecommunications companies;
- video rental records (which may include certain video streaming services);
- driver’s license information and history;
- children’s information; and
- marketing.

Outside of sector-specific laws, certain privacy protections are afforded by the general prohibition against unfair and deceptive trade practices, which has been interpreted to require appropriate notice to consumers about privacy or other practices, including the information collected, obtaining consent to sharing of sensitive data, or the failure to abide by representations made in privacy policies (including those about information security).

In addition, each state has its own consumer privacy and protection framework. Many state laws address privacy-related issues, such as requirements for data security, compliance with the Payment Card Industry Data Security Standard (PCI-DSS), storage of data, privacy of health data, disposal of data, privacy policies, appropriate use of social security numbers and data breach notification, among other things. States also have consumer protection laws that seek to protect consumers against unfair and deceptive trade practices, and state attorneys general typically enforce these laws against businesses (though, in some states a private right of action is available against companies that violate state consumer protection laws). State privacy laws typically track the location of the data subject or the consumer, regardless of where the business is located.

In the US, companies should generally:

- develop, implement and follow a privacy policy;
Money laundering and regulated regulations

Money laundering generally refers to concealing or disguising the existence, illegal origins, or illegal application of criminally derived income so that such income appears to have legitimate origins or constitute legitimate assets. Money laundering is typically associated with funds or proceeds derived from illegal activities, such as tax violations, environmental crimes, foreign corruption, healthcare offenses, fraud, drug trafficking, arms smuggling, prostitution, racketeering, or terrorism.

There are numerous federal anti-money laundering (AML) and combating the financing of terrorism (CFT) laws in the US, including the Money Laundering Control Act of 1986, criminal money laundering statutes contained in 18 U.S.C. §§ 1956 and 1957, the amendment to the Bank Secrecy Act (BSA), and certain provisions of the Uniting and Strengthening America by Providing Appropriate Tools to Restrict, Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act).

Individuals convicted of AML/CFT offenses can face imprisonment, as well as criminal and/or civil penalties. Companies that violate AML/CFT laws can face administrative, criminal, and civil penalties depending on the circumstances. Enforcement agencies may also seize and forfeit funds and property tainted by AML/CFT violations.

FinCEN is responsible for administering the BSA and also is empowered to bring civil enforcement actions for BSA violations. In addition to the federal regime, several US states have promulgated their own AML/CFT laws and regulations.

All US persons are prohibited from engaging in AML/CFT violations and transactions involving sanctioned jurisdictions or persons. In addition, US ‘financial institutions’ – which include not only traditional banks but also other organizations such as MSBs, casinos, pawn shops and many state-regulated financial institutions – must take additional steps such as:

- filing currency transaction and suspicious activity reports; and
- establishing and implementing written AML/CFT programs.

What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

In the US, initial outside investment in FinTech businesses is usually provided by private placements of securities sold to persons with a preexisting substantive relationship to the company or its founders, such as sophisticated friends or family or persons with whom they have had prior business dealings. Seed funding may also be provided by early stage ‘angel’ investors or incubator or accelerator programs. Investments usually take the form of equity or instruments convertible into equity. Seed funding is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company’s development. The seed investors would typically not require the same controls over the business as, for example, venture capital (VC) investors.

CROWDFUNDING AND ‘ACCRREDITED INVESTOR CROWDFUNDING’

In the US, the sale of securities via crowdfunding has been underused, primarily due to the costs of compliance. For example, it requires using a registered broker-dealer or a registered ‘funding portal’, thereby prohibiting direct sales. It also requires providing specified disclosures and complying with many other requirements, including a USD2,000 limitation on the amount from any investor and a USD1 million limitation on the amount that can be raised. This resulting cost of using the exemption, together with the perceived stature of the businesses resorting to this exemption and concerns that its use could limit future financing options or M&A transactions, has resulted in low uptake of crowdfunding in the US.

The recent advent of Initial Coin Offerings (ICOs), token generation events and other blockchain-enabled financing structures has resulted in increased use of a relatively new technique sometimes referred to as ‘accredited investor crowdfunding’. In short, this involves using general solicitation to locate ‘accredited investors’ (as defined in Rule 501 of Regulation D), provided that sales only occur to those who...
the issuer has taken reasonable steps to verify are accredited investors. These steps generally involve reviewing independent documentation (not just self-certification by the investor), such as reviewing Forms W-2, tax returns, bank and brokerage statements, or confirmatory letters from investment advisors, broker-dealers, accountants, or lawyers. Other conditions apply, including that the securities sold are 'restricted securities' subject to resale limitations.

**Venture capital and debt**

VC funding is usually more suitable for FinTech companies that, while still early-stage, have more established businesses. VC investors usually acquire equity in the form of preferred stock, which may include preferences in payment on liquidation, dividends, voting, or other matters. Depending on the amount of investment, VC investors might also require special governance rights, such as the right to designate a director or to observe the board, or certain co-sale, first refusal, or preemptive rights. Many VC investors specialize in particular sectors such as FinTech and therefore can provide tailored business support to FinTech companies.

VC investors include VC funds, which are special funds organized for the purpose of private investing. They may also include corporate VC, where a corporation has formed a fund for deploying investment dollars or making strategic or research and development (R&D) investments.

An additional funding option is venture debt. For example, the lender might provide the company a three-year term loan secured against a company's assets or revenues. The loan may also include an equity component for the lender. Many venture debt providers only invest in companies that have already received VC investment.

**Warehouse and platform funding**

Warehouse financing is a primary means of financing portfolios of FinTech assets. These facilities are most often structured as a loan to a bankruptcy-remote special purpose vehicle that is a newly-formed subsidiary of the originator.

**Senior bank debt and capital markets funding**

**SENIOR BANK DEBT**

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

**CAPITAL MARKETS FUNDING**

When a company has grown to a sufficient size, an Initial Public Offering (IPO) may be a way to raise funds. Typically, an IPO will include listing the company's shares on a national securities exchange, such as the New York Stock Exchange or Nasdaq. Financial and technology sector companies are staples of the US capital markets, consistently representing a meaningful portion of US IPOs. In the last 12 months, technology companies have represented approximately 20%, and financial services companies have represented about 11%, of US IPOs.

As described above, capital markets securitizations are also used by more mature originators as another source of liquidity.

**Incentives and reliefs**

To encourage early-stage investment in small, active businesses, section 1202 of the Internal Revenue Code (IRC) allows a non-corporate shareholder to exclude from gross income gain up to the greater of:

- USD10 million; or
- 10 times the adjusted basis of the investment that results from the sale or exchange of qualified small-business stock.

A qualifying small business must be a US C corporation whose aggregate gross assets immediately following the issuance of shares do not exceed USD50 million. In addition, the shareholder must have acquired the shares at their original issuance and then held them for at least five years.

A startup company may elect to deduct certain ‘startup expenditures’ incurred before the business is established over the 180-month period beginning with the month in which the active trade or business begins. A ‘startup expenditure’ generally means certain amounts
paid or incurred in connection with either investigating or creating an active trade or business.

Taxpayers can also avail of R&D tax credits under section 41 of the IRC, for expenses stemming from qualifying research activities. The available credit ranges from 14%-to-20% of qualifying expenses over a fixed base amount. Certain companies unable to fully use the tax credit due to startup losses, may be eligible to choose to apply up to USD250,000 of the research credit against payroll tax liabilities.

Section 199A was newly enacted as part of the Tax Cuts and Jobs Act of 2017. Under this provision, owners of sole proprietorships, partnerships, S corporations and some trusts and estates may be eligible for a qualified business income (QBI) deduction for tax years beginning after 31 December 2017. Section 199A permits eligible taxpayers to deduct up to 20% of their QBI, plus 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business, including income from partnerships, S corporations, sole proprietorships, and certain trusts. Unless Congress decides to extend it, Section 199A will not apply to taxable years beginning after 31 December 2025.

Finally, many states have provided tax incentives to attract startup activity. These range from income tax credits to real property tax abatement for new office space.

Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is customarily done in an over-the-counter market. The most common ways of selling loans are by assignment and participation.

Assignment

An assignment is a transfer of rights and obligations and creates direct contractual rights between the borrower and the assignee. Credit agreements typically require the consent of the borrower to effectuate an assignment.

Participation

A participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Credit agreements typically permit participations without the consent of the borrower. Loan transfers are commonly documented using standard form contracts made available by the Loan Syndications and Trading Association.

What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan. Below are some of the key considerations.

Lender eligibility

Credit agreements typically specify eligibility requirements for transferees (a borrower may also have the right to specify certain entities who are disqualified lenders, and loans may not be assigned to such entities).

Minimums

Credit agreements typically specify that assignments must be in a certain minimum amount, though assignments to affiliates are sometimes considered in the aggregate.

Transfer fees
Credit agreements typically require transfer fees be paid to the agent.

Consent

A transfer typically requires the consent of the borrower and the agent.

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

Infrastructure assets in the US are both publicly and privately owned. Traditionally, government entities own and operate most roads and bridges, water supply and wastewater facilities as well as the interstate passenger rail system known as Amtrak. Most energy infrastructure, rail lines and landline and cellular telecommunications networks are privately owned but are subject to regulation by federal, state and local government entities.

Significant attention has been focused in recent years on the state of infrastructure assets in the US. At both the state and federal level, there have been initiatives with respect to assets traditionally owned by public authorities to encourage private investment or to establish public-private partnerships used successfully in many other jurisdictions. For example, at least 33 states and Puerto Rico have enacted laws permitting the use of such public-private partnerships for highway and bridge projects. Also, in 2014, the federal government launched the Build America Investment Initiative which was designed to expand the market for public-private partnerships, among other things.

Energy

Utility-scale electric generation facilities in the US are owned primarily by traditional regulated utility companies and independent power producers both of which are privately owned. Regulated utility companies provide retail electric service directly to residential and industrial customers. Independent power producers sell at wholesale to regulated utility companies, into the open market or directly to industrial customers. Transmission systems in the US are also owned primarily by regulated utility companies.

There are also numerous consumer-owned, not-for-profit electric cooperatives as well as public municipal utilities that provide electric or transmission services on a retail and wholesale basis. In addition, certain generating assets are owned by one of the Department of Energy's four power marketing administrations and the Tennessee Valley River Authority. These generation assets are primarily hydropower or nuclear power facilities. In addition to utility-scale generation projects, sponsors in the US are developing residential and industrial rooftop and small-scale solar facilities as well as wind and gas-fired units. Development of both small and large-scale energy storage units is also increasing in the US.

The electric transmission systems and regional wholesale electricity markets in the US are controlled by independent system operators (ISO) within a single state or regional transmission organizations (RTO) across multiple states. RTOs and ISOs are not-for-profit organizations formed at the direction of the Federal Energy Regulatory Commission with the goal of providing open access to wholesale markets and available transmission.

Electric generation and transmission companies are regulated by the Federal Energy Regulatory Commission as well as a public utility commission at the state-level. Retail utility companies are subject to rate regulation designed to provide a reasonable return but limit costs to consumers. Interconnection with a transmission system is conducted pursuant to a standardized application process in each applicable state or region.

Energy policy is established by the federal government through the Department of Energy. Certain energy assets are also subject to regulation by the US Environmental Protection Agency and similar state agencies based on the impact on the environment and animal species and the treatment of hazardous materials. Nuclear plants are regulated by the Nuclear Regulatory Commission.
The production and transportation of oil and gas in the US is conducted primarily by private companies or municipalities. Pipelines throughout the US allow the transportation of oil and gas from production sources and import terminals to end-users or processing facilities. The Federal Energy Regulatory Commission also regulates the operation of oil and gas pipelines and related processing and import facilities.

**Telecoms infrastructure**

Private telecommunications companies provide wireless and wire-based services directly to consumers in the US. Many telecommunication companies are public companies with shares traded on the US stock market. The telecommunications industry in the US is dominated by several large players. The Federal Communications Commission is the primary regulator. Companies are subject to a complex regulatory scheme including licensing requirements.

**Transport infrastructure**

Freight rail in the US includes seven major carriers and dozens of smaller railroads all of which are privately owned. These companies own most of the tracks and related infrastructure.

The National Railroad Passenger Corporation or Amtrak is a for-profit corporation subsidized by the US, state and local governments. It was created by Congress pursuant to the Rail Passenger Service Act of 1970. It provides passenger rails services to 46 states and the District of Columbia and also operates certain commuter rail systems. Amtrak pays freight railroad companies for the use of their tracks.

Railroads in the US are regulated by the Federal Railroad Administration, an agency within the Department of Transportation, as well as state and local authorities. The Federal Railroad Administration has established a program to encourage the development of high-speed rail in the US.

**Other infrastructure**

Water supply in the US is provided via public water systems managed by state or local authorities. Wastewater treatment facilities are owned and operated primarily by local utilities or public water authorities although there has been some private investment in such facilities. Publicly supplied water is subject to federal standards issued by the federal Environmental Protection Agency.

Many roads and bridges are public assets operated by federal, state and local authorities, including the federal Department of Transportation. However, there are numerous private roads and bridges in the US. Many toll roads have been established via private investment and are operated as for-profit businesses.

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**Are there special rules for investing in energy and infrastructure?**

**Generally**

The Committee on Foreign Investment in the United States (CFIUS) reviews the national security implications of transactions that would result in a foreign entity controlling a US business. CFIUS has at times found control when an entity has acquired less than 20% of the equity of a business. The President is authorized to suspend or prohibit a transaction under CFIUS jurisdiction when the President finds credible evidence that a foreign person controlling a US business might take action that threatens to impair the national security, and when no other provision of law (other than the International Emergency Economic Powers Act) provides suitable alternative authority. CFIUS does not have jurisdiction over greenfield investments or passive equity investments of 10% or less.

Section 7 of the Clayton Antitrust Act of 1914 (Clayton Act) prohibits 'acquisitions of assets or voting securities, the effect of which may be substantially to lessen competition or to tend to create a monopoly.' Enforcement standards applied by the US Department of Justice and the Federal Trade Commission are described in their Horizontal Merger Guidelines. Many transactions are reviewed pursuant to the Hart-Scott-Rodino Amendments to the Clayton Act which require formal advance notification to US Department of Justice and the Federal Trade Commission for many acquisitions of assets or equity interests over a certain size (currently US$80.8 million, a value adjusted annually).

**Energy**
The Federal Energy Regulatory Commission reviews many mergers and acquisitions involving energy assets pursuant to the Federal Power Act. It is in charge of determining the impact of the proposed transaction on competition and rates and reviewing concerns regarding the concentration of market power. Certain states also require the approval of such transactions by the state public utility commission. Many regulated and private energy companies seek to impose restrictions on the change in ownership or control of energy assets or company or the direct transfer of such assets via contractual limitations placed in long-term power purchase agreements, interconnection agreements as well as construction, supply, warranty and operation and maintenance agreements.

Telecoms infrastructure

As noted above, the Federal Communications Commission is the primary regulator of the telecommunications industry in the US. The transfer of licenses or companies holding licenses is subject to the review of the Federal Communications Commission. Pursuant to the Communications Act, the Federal Communications Commission is charged with determining if the proposed transaction will serve the public interest.

Transport infrastructure

Most investment in the transport infrastructure sector involves the US Department of Transportation (DOT) or an agency within the DOT, in addition to state and local transport authorities. By way of example, investments in roads, bridges and tunnels typically involve the Federal Highway Administration, an agency within the DOT. There are typically a number of legal requirements which must be met by such projects. The Federal Aviation Administration, also within the DOT, oversees the aviation sector. Public transit projects generally fall under the purview of the Federal Transit Administration, also a part of the DOT. Passenger rail and freight rail matters are governed by the Federal Railroad Administration which is once again included within the DOT. The DOT and local port authorities also handle port related matters.

Other infrastructure

In the US, social infrastructure such as schools, housing and hospitals are often operated by state or local authorities although of course many such assets are privately owned and operated. Increasingly, such projects are developed via public-private partnerships. In such cases, the applicable state or local government entity seeking a private investor to partner with will typically establish the relevant requirements in the applicable request for proposals.

What is the applicable procurement process?

Investing in energy and infrastructure

Generally, project sponsors establish new special-purpose entities to develop individual energy and infrastructure projects. As a result, many energy companies are structured with a parent company, various holding companies and individual projects companies. Investors may acquire an equity interest in specific project companies or in the upstream holding and parent companies. These transactions are typically accomplished via a negotiated purchase agreement. The transaction remains subject to the procurement of necessary regulatory and contractual approvals.

As for the procurement of power and related capacity and ancillary services by regulated utility companies, such companies often conduct requests for proposals (RFP) based on a standard-form agreement. Procurement is based on a procurement plan revised each year and subject to review by the state public utility commission. A public RFP process is managed pursuant to applicable legal requirements and is intended to promote competition and a fair assessment of the available offers. The result is typically a long-term power purchase agreement which forms the economic basis for the development and financing of the applicable generation project. Contracts with retail utility companies are typically subject to approval by the state public utility commission. Retail utilities and industrial customers may also engage in direct bilateral negotiation of such agreements. In recent years, a number of local cooperatives and industrial customers, such as manufacturing facilities, and public customers, such as universities and hospitals, have sought location-specific generation in the form of small generation units, including rooftop solar.

Financing energy and infrastructure

The procurement of financing for energy and other infrastructure projects typically involves negotiation with a bank, financial institution or
other lender or investor active in the infrastructure financing market. Often, such an entity is engaged as an arranger to assist with the marketing and syndication of the proposed financing to other players in the market in exchange for the payment of a fee. Many developers and sponsors rely on long-term relationships with such financing parties.

The financing of transport sector infrastructure projects often involves federal Transportation Investment Generating Economic Recovery (TIGER) grants. Rail projects may find funding via Railroad Rehabilitation and Improvement Financing (RRIF) loans. State and/or local governmental agencies also often contribute to the funding of transport projects. These matters are often developed as public-private partnerships (P3). Such P3 infrastructure projects are expanding beyond the traditional transport sector to include schools, housing, hospitals, courthouses, marinas, parking garages and other types of 'social infrastructure.'

**What are the most common forms of funding / investing in energy and infrastructure?**

**Funding**

Financing infrastructure projects in the US can involve different forms of financing:

- traditional loans at the corporate level based on the balance sheet of the parent or holding company;

- project financing which involves loans to or bonds issued by the applicable project company secured by the project assets and equity in the project company – these may include construction and term loans, working capital loans, letter of credit facilities and asset-based securitizations, and the financing may involve a simple project or a portfolio of projects;

- tax equity investments which involve the acquisition by the financing party of an equity interest in order to take advantage of certain tax benefits, such as the production tax credit and the investment tax credit – as above, these financings are used to fund a single project or a portfolio of projects;

- sponsor loans or mezzanine debt;

- municipal bonds (used by state and local governments for public projects) which are typically exempt from federal, state and local taxes – bonds may be supported by fee-based revenues such as those generated by a toll road; and

- federal and state grants, loans or incentives used to fund public and private infrastructure assets – these programs vary by location and asset class (e.g. the federal government has established the Drinking Water State Revolving Fund and the Clean Water State Revolving Fund which offer low-interest loans to local authorities for water supply and wastewater facilities).

**Investing**

Direct investment in infrastructure often involves the purchase of an equity interest in applicable holding or project companies. In the US, active sponsors and developers often play multiple roles in transactions and an affiliate will act as the contractor, equipment supplier or operator in connection with such an investment. A number of energy companies have created joint ventures to facilitate such transactions.

As noted above, infrastructure projects may also be structured as public-private partnerships.

**Restructuring**

**Enforcement and sanctions**

*When can there be regulatory investigations?*

**Authority to commence an investigation**

The following outlines the various circumstances in which regulators have the authority to commence an investigation.
US SECURITIES AND EXCHANGE COMMISSION (SEC)

The SEC can issue subpoenas in connection with any investigation of violations of the Securities Act of 1933 or the Securities Exchange Act of 1934 (SEA).

The SEC conducts investigations in connection with violations of SEC Rule 10b-5, which broadly makes it unlawful for any person to commit fraud in connection with the sale or purchase of any security.

Criminal enforcement of the federal securities laws is done through the US Department of Justice and individual US Attorney's offices throughout the US.

FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA)

FINRA may, in connection with an investigation, complaint, examination, or proceeding under the FINRA By-Laws or rules, require testimony under oath or inspect the books and records of any FINRA member or person associated with a FINRA member.

FEDERAL RESERVE

If the Federal Reserve determines that a supervised institution — state member banks, bank holding companies, savings and loan holding companies, non-bank subsidiaries of bank holding companies and of savings and loan holding companies, edge and agreement corporations, branches and agencies of foreign banking organizations operating in the US and their parent banks, officers, directors, employees, and certain other categories of individuals associated with the above banks, companies, and organizations (referred to as ‘institution-affiliated parties’) — has problems that affect its safety and soundness, or that the institution is not in compliance with applicable laws and regulations, the Federal Reserve may, by law, take action to ensure that the institution undertakes corrective measures.

The Federal Reserve may also pursue informal enforcement action through board resolutions or Memorandums of Understanding.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

The FDIC pursues formal enforcement actions against FDIC-insured state chartered banks that are not members of the Federal Reserve System, including FDIC-insured branches of foreign banks, officers, directors, employees, controlling shareholders, agents and other institution-affiliated parties associated with such institutions for violations of laws, rules, or regulations, unsafe or unsound banking practices, breaches of fiduciary duty, and violations of final orders, conditions imposed in writing or written agreements.

The FDIC may also pursue informal enforcement action through board resolutions or Memorandums of Understanding.

OFFICE OF FOREIGN ASSETS CONTROL (OFAC)

The Department of Treasury’s OFAC may issue subpoenas in connection with any apparent violation of US economic sanctions laws, including the International Emergency Economic Powers Act, the Trading with the Enemy Act, the Foreign Narcotics Kingpin Designation Act, and other statutes administered or enforced by OFAC, as well as related executive orders, regulations, orders, directives, or licenses.

OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

The Department of the Treasury’s OCC uses informal and formal enforcement actions to ensure national banks, federal savings associations, federal branches, and agencies of foreign banks comply with the program, recordkeeping, and reporting requirements of the Bank Secrecy Act, its implementing regulations, and related anti-money laundering laws.

FEDERAL TRADE COMMISSION (FTC)

The FTC has authority to subpoena witnesses for testimony and require the production of documents if it has ‘reason to believe’ the law is being violated through unfair or deceptive acts affecting commerce.

Investigations may be originated upon the request of the President, Congress, governmental agencies, the Attorney General, upon referrals by the courts, upon complaint by members of the public, or by the FTC upon its own initiative.

CONSUMER FINANCIAL PROTECTION BUREAU (CFPB)
The CFPB may issue a ‘civil investigative demand’ (CID) to any person believed to be in possession, custody, or control of documents or testimony relevant to a violation of federal consumer protection laws.

**Standard for commencing an investigation and issuing an administrative subpoena**

In general, the standard for commencing an investigation or issuing an administrative subpoena is relatively low. Generally, the standard is met by having a good-faith basis for believing that an investigation may address conduct that falls within the jurisdiction of the relevant regulatory agency. By way of example, the SEC Division of Enforcement's Operating Manual notes that the relevant SEC staff 'should determine whether the known facts show that an enforcement investigation would have the potential to address conduct that violates the federal securities laws. The SEC Division of Enforcement receives information from a variety of sources that may warrant the opening of a new Matter Under Inquiry (MUI), including newspaper articles, complaints from the public, whistleblowers, and referrals from other agencies or self-regulatory organizations (SROs).’ The manual emphasizes that these sources are 'suggestions only and should not discourage the opening of an MUI based on partial information.'

It is not uncommon for regulators, and even prosecutors, to commence investigations simply because of allegations of misconduct in press reports.

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**What regulatory penalties may apply?**

The following is a list of regulatory penalties that may be imposed when a rule breach has occurred.

**US Securities and Exchange Commission (SEC)**

- Cease-and-desist orders and injunctions
- Civil money penalties for each act or omission that violates any relevant statutory provision or rule
- Disgorgement of fees, compensation or profits
- Rescission of transactions
- Willful violations may be prosecuted as criminal violations, with large fines to entities and potential incarceration for individuals

**Financial Industry Regulatory Authority (FINRA)**

- Censure, fine, suspension of membership and/or registration, expulsion, cease-and-desist order, or any other fitting sanction

**Federal Deposit Insurance Corporation (FDIC) and Federal Reserve**

- Cease-and-desist orders
- Restitution or reimbursement
- Indemnification or guaranty to third parties harmed by the wrongful conduct
- Removing institution-affiliated party from the banking institution and prohibiting the party from participating in banking at other financial institutions
- Civil money penalties against institution or institution-affiliated parties

**Office of Foreign Assets Control (OFAC)**

- Blocking actions against assets within jurisdiction of the US
- Civil money penalties

**Office of the Comptroller of the Currency (OCC)**

- Cease-and-desist orders
What criminal penalties may apply?

The regulators may impose criminal penalties in certain cases, including:

- securities or commodities fraud (a fine, imprisonment of not more than 25 years, or both);
- money laundering (violations of 18 US Code section 1956 may involve a fine, imprisonment for not more than 20 years, or both and violations of 18 US Code section 1957 may involve a fine, imprisonment for not more than ten years, or both);
- economic sanctions (a fine, imprisonment of not more than 20 years, or both);
- mail and wire fraud (a fine or up to 20 years of imprisonment, or both and if the violation affects a financial institution, the fine may be up to USD1 million, imprisonment for not more than 30 years, or both);
- conspiracy (a fine, imprisonment for not more than five years, or both if charged under 18 US Code section 371, and a fine, imprisonment for not more than 20 years, or both, if charged with conspiring to commit mail or wire fraud under 18 US Code section 1349); and
- breaches of the Bank Secrecy Act (a fine, imprisonment for not more than five years, or both and willful violations may involve a fine, imprisonment for not more than ten years, or both).

For all of the above-mentioned charges, courts may also impose both forfeiture and restitution orders.
No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

STATE AND LOCAL TAXES

Generally, no stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan. However, some jurisdictions (e.g. Florida) impose a documentary stamp tax on loans if the obligation is evidenced by a document (e.g. a note).

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

FEDERAL TAXES

No stamp, registration, transfer or other similar taxes are payable on the taking, transfer or assignment of a mortgage, debenture or other security.

STATE AND LOCAL TAXES

Many jurisdictions (including New York and Florida) impose a documentary tax upon the recording of a mortgage. However, when a mortgage is assigned to a new lender without any increase in the amount of the secured indebtedness, the parties may be able to file an affidavit to be exempt from the mortgage recording tax. Likewise, some states will provide a credit for recording tax previously paid in connection with the assigned mortgage.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

FEDERAL TAXES

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security.

Debt instruments are typically held ‘in registered form’ because there are sanctions and penalties imposed on both the issuers and holders of bearer bonds. For issuers, these penalties can include the imposition of an excise tax and the denial of interest deductions. For holders, these penalties can include the denial of certain loss deductions or capital gain treatment upon sale, transfer, assignment or other disposition of the debt instrument and the denial of the beneficial portfolio interest exemption from withholding tax on interest payments.

STATE AND LOCAL TAXES

Generally, there are no stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security.

However, some jurisdictions (e.g. Florida) impose a documentary stamp tax on loans if the obligation is evidenced by a document (e.g. a bond).

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Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

FEDERAL TAXES

Although the United States Internal Revenue Service has a super-priority lien that arises upon the assessment of a federal tax even before a notice of tax lien is filed, federal tax liens do not take priority over secured creditors with respect to their collateral.

STATE AND LOCAL TAXES

State taxing authorities do not take priority over secured creditors with respect to their collateral. However, there is an exception for real property taxes, which are liens themselves by statute in each local jurisdiction.
Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

FEDERAL TAXES

Generally, withholding tax is imposed on payments of interest to persons not resident in the US. However, there are important exceptions often utilized as discussed below.

Interest payments to certain 'foreign financial institutions' or 'non-financial foreign entities' may also be subject to withholding under the Foreign Account Tax Compliance Act if the foreign financial institution fails to enter into an agreement with the IRS which meets certain requirements.

STATE AND LOCAL TAXES

Generally, there is no withholding on interest payments.

However, some states (e.g. California) may impose backup withholding on interest received on loans used in a trade or business conducted in the state unless a proper exemption certificate is provided. For California purposes, dividends, interests, and any financial institutions release of loan funds made in the normal course of business are exempt from backup withholding.

If so:

What is the rate of withholding?

The current rate of US federal tax withholding on interest paid to persons not resident in the US is 30%.

What are the key exemptions?

FEDERAL TAXES

The most commonly relied upon exemptions to ensure that interest paid by US companies to persons not resident in the US can be paid without any US withholding tax include:

- the portfolio interest exemption ((i) a non-US lender (which is unrelated to the US borrower, is not a bank, is not a 'controlled foreign corporation', and is not engaged in the conduct of a US trade or business), (ii) lends money to a US borrower pursuant to a registered debt instrument which pays a fixed rate of interest, and (iii) the non-US lender provides adequate documentation as to its non-US status);
- lending using commercial paper (original issue discount notes with terms of 183 days or less);
- qualification under a US tax treaty for no withholding or reduced withholding; or
- loans by a lender that engages in a trade or business in the US and that will report the interest as income effectively connected with that trade or business. However, any such effectively connected income is subject to US federal income taxation at regular graduated tax rates.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

FEDERAL TAXES

The analysis described above is applicable to interest payments under both a loan and other forms of debt instruments; provided it is in registered form (for portfolio interest exemption purposes).

Are foreign lenders and debt security holders subject to tax on interest payments?
Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

**FEDERAL TAXES**

A lender which is not resident in the US, e.g. a corporation, can be subject to income tax in the US at regular graduated tax rates, even without a physical presence, by engaging in a financing trade or business, or using the debt instrument in any other trade or business within the US. To have such a trade or business, US activities must be conducted on a considerable, continuous, and regular basis.

**STATE AND LOCAL TAXES**

A lender which is not resident in the US, e.g. a corporation, can be subject to income tax in the jurisdiction of the borrower even without a physical presence by engaging in a financing trade or business or otherwise using a note in its trade or business within that jurisdiction, or simply based on receiving a certain threshold of interest from borrowers and other income from within the jurisdiction (so called 'economic nexus').

**Would the same analysis apply to interest payments under a debt security (e.g. a bond)?**

**FEDERAL TAXES**

Yes, the analysis described above is applicable to interest payments under both a loan and other forms of debt securities.

**STATE AND LOCAL TAXES**

Yes, the analysis described above is applicable to interest payments under both a loan and other forms of debt securities.

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**Key contacts**

**John T. Cusack**

Partner  
DLA Piper LLP (US)  
john.cusack@dlapiper.com  
T: +1 312 368 4049