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The basics, and some changes

Ana Sofia Silva of Cuatrecasas Goncalves Pereira explains how capital raising is carried out in Portugal, as well as how supervision will change going forward

Capital raising by companies may be achieved either through equity or debt financing. This article presents an overview of the alternatives present in the Portuguese jurisdiction focusing, where applicable, on innovative paths and trends.

During the international financial crisis, which burst in September 2008, with the dilution of investor confidence and the difficulties for the banking sector in raising liquidity, Portuguese companies have seen their access to finance constrained (either through a real deterioration in the availability of credit or through increases in the charges, fees and commissions or tighter procedures, collateral and security requirements).

In this regard, several measures have been adopted at an European level and internally, with the European Central Bank approving new measures regarding monetary policy and the Portuguese Government enabling new legislation on the granting of extraordinary personal guarantees by the Portuguese state to Portuguese credit institutions and to branches of international banks established in Portugal, up to a global amount of €20 billion. These measures have ensured bank commitments under credit facilities while safeguarding the role that credit plays in stimulating growth.

Banks have favoured this temporary framework and, by the end of 2009, six credit institutions had benefited from it, in an aggregate volume of €4.95 billion. At the date this article was prepared, and although the most critical turmoil had already been overcome, the proposal for the annual budget for 2010 presented by the government and still pending approval in specialty from the Parliament aimed at extending this regime until the end of 2010 while reducing the respective limit to €10.15 billion. However, the European Commission has decided, on February 22 2010, that temporary rescue measures to overcome the financial crisis should only be available until June 30 2010.

In Portugal, the most common forms of incorporation are:

- *Quota* companies (*sociedades por quotas*) whose equity capital is represented by *quotas*. *Quotas* are evidenced through the articles of incorporation and the commercial registry; and
- Share companies (*sociedades anónimas*) whose capital is represented by shares that may be materialised or dematerialised (book-entry) and be nominative or bearer shares.

A great role is also played by the public corporate sector (*sector empresarial do Estado*), which comprises public companies (*empresas publicas)* and corporate public entities (*entidades públicas empresariais*).

When considering capital growth initiatives, the company will have to determine the right source of capital: whether to use shareholders' contributions or external financing and in the latter case whether to be financed through the capital markets or by the banking sector.

Shareholder contributions

As far as self-financing is concerned, the Portuguese Companies Code (PCC) sets forth three legal institutes:

- Accessory contributions (*prestações acessórias*) (either in cash or in kind);
- Supplementary contributions (*prestações suplementares*) (always in cash); and
- Shareholder loans (*suprimentos*) (either in cash or in any other fungible assets).

Accessory contributions need to be permitted by the company's by-laws, which also establish their terms and conditions. Supplementary contributions must be authorised by the company's by-laws, but in order to be demanded from shareholders additionally require a shareholder resolution. Shareholder loans do not require any written formalities.

Whilst supplementary contributions do not earn interest, accessory contributions and shareholder loans may be remunerated or not.

Supplementary contributions may only be reimbursed provided the legal requirements are met. The PCC does not set forth a general principle applicable to the reimbursement of accessory contributions and shareholder loans, although limiting the reimbursement of the later (notably by determining that in a default by the company, the shareholder is not entitled to apply for its insolvency).

Share capital increase

The increase of share capital may be executed either by entries in cash or in kind.

The increase of a *quota* company's capital, either executed by the increase of the nominal value of the original *quotas* or through the issue of new *quotas* requires a resolution of the general meeting passed by a three-quarters majority.

The share company's capital increase by entries in kind must be decided by the general meeting, whilst increases by entries in cash may be decided by the board of directors, provided it has been entitled to do so by the company's by-laws.

Share companies' by-laws may authorise, other than ordinary shares, the issue of non-voting preference shares of up to half the total amount of the share capital. These shares entitle their owner to priority in any profit distribution of up to five per cent of the nominal value of the shares, and priority in the event of a return of capital on the liquidation of the company. Apart from voting, these shares entitle their owners to all other rights granted by ordinary shares. Additionally, special rights may be attached to certain classes of shares (such as profit distributions and certain voting privileges), provided it is legally permitted and set forth in the company's by-laws. Furthermore, and provided all legal requirements are met, shares may be issued at a premium.

In Portugal share capital increases are subject to pre-emption rights and financial assistance provisions.

Qualified shareholdings and mandatory takeovers

Portuguese law sets forth special reporting duties regarding the acquisition of qualified shareholdings in Portuguese companies whose share capital is open to the public (*sociedades abertas*) or in companies admitted to trading in a regulated market located in Portugal.

These special duties are triggered by different thresholds depending on the relevant companies. The Portuguese Securities Commission (*Comissão do Mercado de Valores Mobiliários* – CMVM) is entitled to suspend the exercise of all rights

related to the qualified holdings whenever the respective shareholders disregard the abovementioned reporting duties.

At the date this article was produced, a new regulation had been proposed by the CMVM regarding the extension of these reporting duties to investors in derivative transactions granting the right to acquire shareholdings (such as differential and equity swaps).

Direct or indirect acquisition of a qualified shareholding in *sociedades abertas,* representing one third (provided proof is not made that the one-third percentage does not grant a controlling shareholding) or one half of the respective voting rights triggers the obligation to launch a mandatory takeover bid for the remainder shares.

Author biographies

Ana Sofia Silva

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Ana Sofia Silva holds a Law Degree from the University of Lisbon Law School in 2000 and graduated in Banking, Stock Exchange and Insurance Law from the University of Coimbra Law School, in 2002. She was admitted to the Portuguese Bar in 2000 and has been an associate lawyer of Cuatrecasas, Gonçalves Pereira & Associados since 2002.

Her main areas of practice are finance law, capital markets and banking law, structured finance (namely cross-border leasing), corporate finance, asset finance, debt issues and Schuldschein loan agreements, financial derivatives, Structured Financing Instruments (such as asset-backed securities and so-called unit linkeds) and insurance law.

The main projects on which she advised in the last years include, structured financing, domestic and cross-border leasing, financing operations by debt issue, legal advice on interest-rate swaps and credit-default swaps and on Structured Financing Instruments. She is a member of the Portuguese Bar and speaks Portuguese, English, Spanish and French.

Debt securities

The most common forms of debt securities are commercial paper and bonds. Besides the abovementioned, hybrid mechanisms allow the issue of convertible debt (such as bonds convertible into shares).

Commercial paper is short-term debt securities whose legal regime sets forth legal requirements regarding either the capacity and the terms and conditions of the respective offering, whilst establishing a simplified model of information to the market and the possibility of registration with any centralised system for securities.

Bonds are medium and long-term debt securities, whose legal regime, initially established in the PCC, was accommodated by Decree Law 52/2006 of March 15 and by Decree Law 76-A/2006 of March 29, in order to generate more simple and flexible solutions.

Provided the requirements established by law are met, bonds may be issued by share companies, *quota* companies and public corporations.

Companies cannot issue bonds totalling more than twice their own funds, as determined by the criteria established in the PCC. This limit does not apply to (i) issuers whose shares are admitted to trading on regulated markets, (ii) companies that have the bond issue rated by credit rating agencies registered with the CMVM and (iii) issues where redemption is secured by special guarantees granted in favour of the bondholders.

Regardless of whether the issue is subject to the limit mentioned above, issuers are prevented from reducing their share capital below the value of their debt towards bondholders, unless that reduction is due to losses carried over, in which case special measures must be taken to strengthen legal reserves.

The issue of bonds, on a stand-alone or on a programme basis, must be decided by the general meeting unless the by-laws authorise the board of directors to resolve the issue.

Bonds may be traded over the counter or on a regulated market. In the latter case the bond issue will not be subject to prior commercial registration.

Decree Law 193/2005, of November 7, aimed at exempting withholding tax applicable to investment income and capital gains arising from debt securities represented a major innovation, by notably determining that the debt securities are held through Interbolsa.

Led by this new regime, a growing number of issuers has come to the market, since 2006, including major public corporations, private companies and the Portuguese state.

Although bond issues are not subject to Portuguese stamp duty, eventual security granted in connection therewith will be levied.

Securitisations

The Portuguese Securitisation Law (PSL) in force provides an attractive and flexible basis for setting up new transactions by allowing diversification of assets by Portuguese originators while promoting corporate and public corporation securitisation.

Corporate and public corporations' securitisations backed by receivables and future cash flows are a deal opportunity.

In order to be deemed eligible to be included in a securitisation portfolio, receivables must result from an existing, ongoing relationship and be quantified or quantifiable. These criteria assume major relevance regarding opportunities for electricity, natural gas, mobile phones, telecommunications and cable services companies, and are also quite attractive for public corporations while reducing their debt burden by allowing the proceeds for securitised assets to be treated as budgetary revenues.

PSL allows the inclusion of overdue credits in securitised portfolios, the creation of portfolios with different types or categories of assets owned by one originator, the issuance of different classes of securities (combining securitisation notes and units) as well as the setting up of transactions with more than one originator. Furthermore, it entitles all kinds of originators to apply before CMVM for a notification exemption, therefore eliminating the inefficiencies created by the original version which determined that whilst assignments made by Portuguese state, credit institutions and financial companies became effective regardless of notification, other types of originators, notably corporate entities, would always have to notify its debtors.

Besides these key aspects, securitisations benefit from a special tax regime more advantageous than that applicable to loans and other debt financing instruments.

Process of issuing securities

The legal regime dealing with the offering of securities is contained in the Portuguese Securities Code (PSC), which has enacted the applicable provisions of the relevant EC Directives (notably the Prospectus Directive and the Directive on Takeover Bids).

The rules here apply regardless the type of securities being issued.

The main distinction to be made in the

Portuguese jurisdiction is that between public offers (those that are (i) addressed to unidentified addressees; (ii) addressed to all shareholders of a *sociedade aberta*, irrespective of the share capital being represented by nominative shares; (iii) wholly or partially preceded or accompanied by promotional material or book-building with unidentified addressees; or (iv) addressed to more than 100 non-qualified investors resident or established in Portugal) and private offers (an offer is considered to be private where it does not qualify as a public offer, despite some situations always classified as private offers (such as offers addressed to qualified investors only)).

PSC provides a definition of qualified investors in line with the EC Directives.

Public offers (i) must take place through an authorised financial intermediary; (ii) are subject to prior registration with CMVM; (iii) require a prospectus and that all marketing material is subject to prior approval by CMVM. Provided the applicable legal requirements are met, some public offers are not subject to the provisions of the PSC. There are also a number of situations that, although determining the application of the remainder provisions, grant a prospectus exemption.

Private offers by *sociedades abertas* and by issuers whose securities are admitted to trading are subject to subsequent communication to CMVM.

Listing in Portugal is subject to several requirements established by law.

Prospectus requirements

The PSC already incorporates the provisions established by the Prospectus Directive and by Regulation 809/2004/EC of April 29 2004.

Pursuant to the PSC, a prospectus approved by a competent authority of an EU member state regarding a public offer or the admission to trading in a regulated market operating in Portugal benefits from the EU passport rules.

Every prospectus must meet the requirements set forth in the Regulation, including liability statements.

Issuers with registered offices in non-EU member states may require the approval of their prospectus by CMVM provided it has been prepared in accordance with international standards set by international organisations (including Iosco) and contains information, notably of a financial nature, equivalent to that required pursuant to the PSC and the Regulation.

Banking financing

The most common forms of debt funding include term loan agreements, overdrafts, revolving credit facilities, syndicated, structured financing and leasing transactions. Portuguese law sets forth specific requirements on each.

Under Portuguese Law, granting of debt financing is a regulated activity, which may only be carried out by (i) credit institutions and financial companies with head offices in Portugal, (ii) Portuguese branches of credit institutions and financial companies with head offices in other jurisdictions or (iii) credit institutions or financial companies authorised in other EU member states, provided its activity is covered by the respective licence and registered with the Bank of Portugal in order to be performed cross-border under the EU freedom to provide services. The activity of promoting transactions that constitute banking regulated activities is also restricted to the entities entitled to carry out such activity in Portugal.

The PCC limits a company from guaranteeing the debts of other companies to the cases where the guarantor has a justified corporate interest or is in a group or control relationship with the company. Although there isn't a legal definition of justified corporate interest, it has increasingly been adopted the principle that it should be regarded as the interest of exploring a business in order to increase its profitability. Group and control relationships are defined in the PCC.

Portuguese law sets forth specific provisions and requirements regarding different types of security, with the main distinction to be made between personal guarantees and guarantees *in rem* (such as mortgages).

Decree Law 105/2004, of May 8, which implemented the financial collateral arrangements Directive, has introduced new forms of security:

- The title transfer financial collateral arrangement (*alienação fiduciária em garantia*), which allows the parties to agree the transfer of full ownership of financial collateral and to set-off; and
- Financial pledges (*penhor financeiro*) whose legal regime aims at simplifying foreclosure procedures.

These collateral arrangements are not subject to the hardening periods set forth in the Portuguese Insolvency Regime.

Portuguese stamp duty may be a hurdle on banking loans. In order to avoid stamp duty replication, security over loans should be materially accessory and granted simultaneously with the loan.

Portuguese companies avoiding gross-up provisions on withholding tax applicable to interest paid to banks that are not domiciled nor have a branch in Portugal, tend to prioritise Portuguese banking financing. Banking loans granted by non-Portuguese entities may however benefit from reduced withholding via double tax treaties.

When structuring debt financing, Portuguese anti-avoidance rules should be considered.

Portuguese supervisory system

The model comprises three entities:

- The Bank of Portugal (*Banco de Portugal*), central bank and supervisory authority of the banking sector;
- The Portuguese Insurance Institute (*Instituto de Seguros de Portugal*), supervisory authority of the insurance industry (including pension funds); and
- CMVM, the securities commission.

Moreover, the National Council of Financial Regulators (*Conselho Nacional de Supervisores Financeiros* – CNSF), aims at enhancing the exchange of information amongst supervisors and better coordinating the respective activities whilst the National Council for Financial Stability (*Conselho Nacional de Estabilidade Financeira* – CNEF), tries to improve cooperation between the Ministry of Finance and the supervisors to reinforce the Portuguese financial system.

Following the measures adopted at a European level pursuant to the de Larosière report of February 2009, the Portuguese government has proposed restructuring the existing model.

Macro-prudential supervision will be granted to the CNEF while the Bank will represent the national authorities before the European Systemic Risk Council. As for micro-prudential supervision, there will be a twin peaks model where the Bank of Portugal is liable for the prudential supervision of the financial markets and institutions while the supervision of the conduct of the financial market players will be granted to a new entity, yet to be created. The CNSF will be responsible for coordinating both supervision dimensions.

Legislation implementing this new model is expected to be approved in the next couple of months and likely to come into force until the end of September of 2010.