CUATRECASAS

Legal framework for participative loans

Legal framework for participative loans, approved by Decree Law 11/2022 of January 12

Banking, finance, and capital markets legal flash

January 21, 2022

Rules for participative loans

- Overview
- Description
- Financing and financed entities
- Formalities
- Remuneration and repayment
- Credit ranking
- Limitations on the financed entity
- Default
- Conversion of credits into share capital
- Transferability

CUATRECASAS

Overview

On January 12, 2022, Decree Law 11/2022 of January 12, approved the legal framework for participative loans (the **"PL Framework"**).

Participative loans, already available in other jurisdictions, e.g., *préstamos participativos*, *partiarisches Darlehen*, and *prêt participatif* under Spanish, German and French law respectively, are a new equity instrument, but in the form of a loan or securities that, in practice, was already used by some entities in an exclusively contractual form.

Description

Participative loans are onerous credit agreements that can take the form of a loan or debt securities (e.g., bonds).

They are recorded as equity instruments if the parties make remuneration conditional on the borrower's profits, and their repayment or amortization meets the rules for distributing goods and profits to shareholders established in the Commercial Companies Code (*Código das Sociedades Comerciais*).

Financing and financed entities

The PL Framework provide clear list of the types of entities that can grant participative loans, which are the following:

a) credit institutions and financial companies;
b) specialized alternative credit investment companies, venture capital firms, and social entrepreneurship investment companies;
c) securities investment companies for the improvement of the economy;
d) the Capitalization and Resilience Fund; and
e) other entities that are qualified to grant credits on a professional basis.

In short, essentially companies that were already qualified to grant credits. Oddly enough, this restriction also applies to securities, which is a new development in the architecture of securities legislation.

As for the financed entities, any non-financial companies can take these loans or issue the securities for this type of debt.

Formalities

Contracting participative loans requires the previous deliberation of the borrower's general meeting, regardless of its format.

If the participative loan takes the form of a loan, it will be made in writing. The documents must expressly mention that the loan falls under the PL Framework, and specify its purpose.

Remuneration and repayment

Remuneration of participative loans can be indexed, exclusively or partially, to a share in the borrower's profits. The PL Framework allow the parties to establish an additional interest rate on the remuneration, which can be capitalized and is independent from the borrower's profits.

The remuneration base can be established as a fixed or variable (growing) percentage of the profits (based on any financial indicator for the profits, such as turnover, EBITDA, and net profit), or can be proportional to the weight of the nominal value of the participative loan in the equity.

Payment of the remuneration and reimbursement will always depend on the existence of distributable profits, and the parties can always agree to make it conditional on the shareholders' previous deliberation.

Credit ranking

Given that participative loans are equity, they are considered subordinated debt, and are ranked immediately above shareholders' claims and the claims of other persons specially related to the borrower.

Limitations on the financed entity

The PL Framework prohibit payment of the remuneration or reimbursement of the participative loan when:

a) the own capital is lower than the total share capital and reserves or would be as a result of the payment or reimbursement; or
b) the year's earnings are necessary to cover losses of previous years or establish or re-establish legal or statutory reserves.

During the term of the participative loan, the financed entity requires the financing entity's authorization to change the statutory terms for distributing profits; attribute privileges to existing shares; reimburse shareholder loans, ancillary and supplementary contributions; redeem shares; or deliberate on the reduction of capital.

Default

If a financed entity does not pay the remuneration, the financing entity can enforce the guarantees provided, which seems to open the way to the establishment of guarantees by the financed entity, expressly departing from the financial assistance regime.

Alternatively, the financing entity can require the conversion of participative loans into share capital.

To audit the results submitted, the financing entity can require an audit of the financed entity's financial situation.

Conversion of credits into share capital

The PL Framework make it possible to request the conversion of the participative loan into share capital when:

a) it has not been fully reimbursed because the relevant terms were not met once the deadline for reimbursement had elapsed;
b) if the remuneration due has not been received for more than 12 months, consecutive or not; or
c) if the borrower's management body does not submit evidence of the approved statements and their filing with the commercial registry 12 months after the legal deadline.

The parties can contractually establish other terms for the conversion of the loan.

The financing entity must make the request for the conversion of the credits into share capital to the financed entity, and also submit the auditor's report.

After receiving the request for conversion, the financed entity must immediately call a general meeting, which will be held within 60 days from the reception of the request and will follow the rules to convert credits into capital.

If allowed by the bylaws, the parties can establish the borrower's right to the conversion of the participative loan, in the circumstances and in the terms expressly specified in the participative loan documentation.

Transferability

Claims arising from participative loan contracts can be freely assigned to third parties, including credit securitization companies.

For more information, please contact Cuatrecasas.

©2022 CUATRECASAS

All rights reserved.
This document is a compilation of legal information prepared by Cuatrecasas. The information and comments in it do not constitute legal advice.
Cuatrecasas owns the intellectual property rights over this document. Any reproduction, distribution, assignment, or any other full or partial use of this document is prohibited, unless with the consent of Cuatrecasas.