CUATRECASAS

Banking, Finance and Capital Markets

Newsletter Portugal

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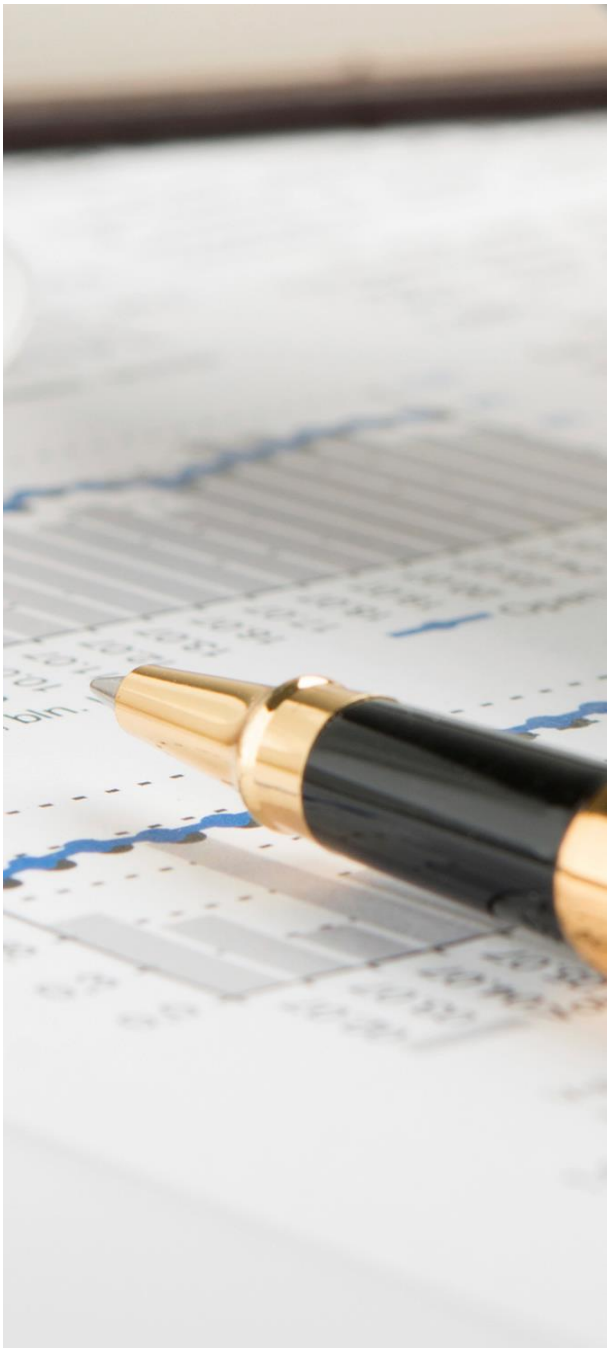

Contents

CMVM Regulation on Loan Funds

CMVM Regulation 5/2020 ("**Regulation 5/2020**") published on April 27, 2020, amends CMVM Regulation 3/2015 ("**Regulation 3/2015**"), which, in turn, regulates the Legal Framework on Venture Capital, Social Entrepreneurship and Specialized Investment, enacted by Law 18/2015, of March 4, 2015 (as amended, the "**VCSESI Framework**").

Regulation 5/2020 regulates the business of Credit Specialized Alternative Collective Investment Undertakings ("**Loan Funds**"), providing for amendments to the requirements to be met by Loan Funds from both a prudential and a behavioral perspective, as summarized below.

I. Prudential scope

Composition of Loan Funds portfolio

Within the scope of their activity, Loan Funds can grant credits (loan origination) and participate in loans acquired from the credit's originator or from third parties (loan participation) that comprise the main type of assets in these funds' portfolios. Note that the maturity of the credits held by Loan Funds cannot exceed the duration of the Loan Fund itself.

Regarding the composition of Loan Funds' portfolios, the following types of assets can be identified under the applicable regulation:

- Liquidity: up to 20% of the Loan Fund's assets, and only after the first six months of activity, which must consist of (i) bank deposits that can be called up at any time; (ii) deposit certificates; (iii) participation units of collective investment undertakings in the money market or short-term money market; and (iv) financial instruments issued or guaranteed by a Member State with a residual maturity below 12 months;
- Debt securities: up to 20% of the Loan Fund's assets, issued by eligible lenders (*i.e.*, those to whom the granting of credit is not barred under article 5-C(b) of the VCSESI Framework); and
- Other assets: arising from payment of the credits (*e.g.*, transfer in lieu of payment) or which are required to maximize payment (*e.g.*, conversion of credits into equity under a special revitalization proceeding (*Processo Especial de Revitalização*).

Regulation 5/2020 further imposes rules on the diversification of the assets held by the Loan Funds after their first year of activity, establishing a maximum credit threshold of 20% of their total assets regarding any entity or group of entities in a control or domain relationship.

- *Assessment and monitoring of credit risk*

Management entities must have in place risk management systems that analyze credit quality and risk (*e.g.*, through management procedures for credit default, restructuring and extension of credits), and they must implement procedures to monitor quality changes in each credit.

- *Stress tests*

Management entities must ensure that the Loan Funds stress tests carried out under article 59(2) of the VCSESI Framework are done at least on a quarterly basis.

- *Corporate governance of the managing entities*

Under Regulation 5/2020, the board of directors of the Loan Fund's managing entity must include at least one member with proven experience in granting credit and credit risk management activities.

- *Annual information on the Loan Funds*

New information obligations have been imposed on the Loan Funds relating to the annual report to the CMVM under article 15(2) of Regulation 3/2015, which will now include information on:

- the breakdown of the credits held as secured preferential debt, subordinated debt and mezzanine debt;
- the breakdown between the credits reimbursed under a payment plan and the credits reimbursed in a single instalment;
- the breakdown of the ratio between the value of the loan and the value of the security for each of the credits held;
- the non-performing exposures and the renegotiation, restructuring and extension of credits; and
- significant changes in the assessment of credits and monitoring procedures.

II. Behavioral scope

Obligations of management entities towards borrowers

Management entities are further subject to complying with certain information obligations regarding the services offered, whether requested or provided, when this information is necessary for an informed and reasoned decision.

These obligations include providing information on:

- the management entity and the services rendered;
- the risks involved in the transactions to be carried out; and
- the cost of the service to be rendered.

Finally, under Regulation 5/2020, management entities are, in the context of their relationships with borrowers, subject to the duty of professional secrecy under the same terms provided for banking secrecy.

Legislation: Banking and Finance Law

Bank of Portugal (BoP) Instructions

Instruction 15/2020 – Official Bulletin 5/2020, 5th Supplement, of June 4, 2020
It discloses the maximum rates to be applied to consumer credit agreements, under Decree-Law 133/2009, of June 2, 2009, in the third quarter of 2020.

Instruction 9/2020 – Official Bulletin 4/2020, of April 15, 2020
It amends, regarding the reporting format, Instruction 17/2009, which regulates the monitoring of compliance with the thresholds imposed on members of the agricultural credit banks (*caixas agrícolas*), defined in article 19 of the Legal Framework of Mutual Agricultural Credit (*Regime Jurídico do Crédito Agrícola Mútuo*) and approved by Decree-Law 24/91, of January 11, 1991 (as amended, the "**MACLF**").

Instruction 8/2020 – Official Bulletin 4/2020, of April 15, 2020
It amends, regarding the reporting format, Instruction 15/2009, which regulates the monitoring of compliance with the thresholds for agricultural credit banks, as established in article 28(2) and (3), and in article 36-A(6) and (7), of the MACLF.

Bank of Portugal (BoP) Circular Letters

Circular Letter CC/2020/00000039 – Official Bulletin 6/2020, Supplement, of June 18, 2020
It underlines the importance of credit institutions complying with the European Banking Authority ("**EBA**") Guidelines for an appropriate estimate of loss given default ("**LGD**") for an economic downturn (EBA/GL/2019/03), applicable in relation to the internal ratings-based method (under Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms) ("**IRB Approach**"), which will come into force on January 1, 2022.

Circular Letter CC/2020/00000038 – Official Bulletin 6/2020, Supplement, of June 18, 2020
It outlines the importance of credit institutions complying with the EBA Guidelines on probability of default estimate, LGD estimate and the treatment of defaulted exposures (EBA/GL/2017/16) applicable in relation to the IRB Approach**,** which will come into force on January 1, 2022.

Circular Letter CC/2020/00000035 – Official Bulletin 5/2020, 4th Supplement, of June 1, 2020
It warns financial entities that, as part of their customer due diligence procedures associated with establishing business relationships and updating procedures, they need to make available to their customers the technological means and services that allow the use of means of proof listed in article 25(2) of Law 83/2017, of August 18, 2017, which establishes the measures on the prevention of money laundering and terrorist financing.

Circular Letter CC/2020/00000029 – Official Bulletin 4/2020, 4th Supplement, of May 6, 2020
It states the EBA Guidelines on information and communication (ICT) and security risk management (EBA/GL/2019/04) and discloses the BoP's expectation that those requirements will be met by payment service providers, credit institutions and investment firms from June 30, 2020.

European Central Bank (ECB) Acts

Regulation (EU) 2020/605 of the ECB, of April 9, 2020 – EU Official Journal L-145, of May 7, 2020
It amends Regulation (EU) 2015/534 on reporting supervisory financial information (ECB/2020/22).

Guideline (EU) 2020/496 of the ECB, of March 19, 2020 – EU Official Journal L-106, of April 6, 2020
It amends Guideline (EU) 2019/1256 on the euro short-term rate (€STR) (ECB/2020/15), addressed to all Eurosystem central banks.

European Banking Authority (EBA) Guidelines

EBA Guidelines on credit risk mitigation, of May 6, 2020
Guidelines on credit risk mitigation for institutions applying the IRB Approach with own estimates of LGDs (EBA/GL/2020/05), which are supplementary to EBA Guidelines (EBA/BL/2017/16) and will enter into force on January 1, 2022.

EBA Guidelines on securitization transactions, of May 4, 2020
Guidelines on determining the weighted average maturity of the contractual payments due under the tranche of a securitization transaction (EBA/GL/2020/04).

Legislation: Insurance and Pension Funds Law

European Union law

Commission Implementing Regulation (EU) 2020/657, of May 15, 2020 – EU Official Journal, L-155, of May 18, 2020
It corrects certain language versions, including several terminology errors in the Portuguese language version, of Implementing Regulation (EU) 2015/2450, which establishes implementing technical standards for the templates used to submit information to the supervisory authorities under Directive 2009/138/EC (also known as the Solvency II Directive).

Commission Implementing Regulation (EU) 2020/641, of May 12, 2020 – EU Official Journal L-150, of May 13, 2020
It establishes technical information for calculating technical provisions and basic own funds for reporting with reference dates from March 31, 2020, to June 29, 2020, under the Solvency II Directive.

Insurance and Pension Funds Supervisory Authority (ASF) Standards

ASF Regulatory Standard 7/2020-R – Official Journal 124/2020, Series II, of June 29, 2020
It establishes the terms and conditions under which transaction involving a potential conflict of interest can be carried out, including contributions in kind to pension funds.

ASF Regulatory Standard 3/2020-R – Official Journal 107/2020, Series II, of June 2, 2020
It regulates the initial provision of information to ASF by mutual associations covered by the supervisory transitional framework.

Legislation: Securities and Capital Markets Law

National law

Decree-Law 12/2020 – Official Journal 68/2020, Series I, of April 6, 2020
It establishes the legal framework applicable to trading the greenhouse gas emission allowance for the 2021-2030 period, implementing Directive (EU) 2018/410 into domestic law.

European Union law

Regulation (EU) 2020/852 of the European Parliament and of the Council, of June 18, 2020 – EU Official Journal L-198, of June 22, 2020
It establishes a framework to facilitate sustainable investment, approving the criteria for qualifying economic activities and corresponding investments as environmentally sustainable and amending Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector.

Securities and Exchange Commission (CMVM) Circulars

CMVM Circular of June 26, 2020
It expresses the CMVM's understanding that proper compliance with the obligation provided under article 50(10)(a) of Commission Delegated Regulation (EU) 2017/565, regarding organizational requirements and operating conditions for investment firms, can be ensured by disclosing to retail investors, before the investment decision, the net internal rate of return (IRR), assuming that the investment is maintained until maturity, and the results of the simulation of costs and charges.

CMVM Circular of May 6, 2020
It publishes the annual circular for real estate appraisers for 2020.

European Securities and Markets Authority (ESMA) Guidelines

ESMA Guidelines on the compliance function, of June 5, 2020
Final guidelines on the compliance function under MiFID II, updating and further developing the 2012 guidelines on the same matter.

ESMA Guidelines on performance fees, of April 3, 2020
Guidelines on performance fees in undertakings for the collective investment in transferable securities and certain types of alternative investment funds, mainly the method for calculating the performance fees, its appropriateness for the fund's strategies and policies, and its disclosure to investors.

Caselaw

National caselaw

Judgment of the Lisbon Court of Appeals, of May 21, 2020 (proceedings 597/14.8YYLSB-B-2)

The Lisbon Court of Appeals was called on to decide on a swap agreement that was not backed by an underlying relationship. The court started by describing the swap agreement referring to its randomness, according to which the parties would not know beforehand whether the interest would go up or down, thus gambling with changes that were favorable to them. The court then upheld that swap agreements, specifically interest rate swaps, play a role in hedging a party's risk and transferring it to the counterparty in terms similar to an insurance agreement, so it classified them as a reciprocal, onerous and random agreements, at least for one of the parties.

Their hedging nature depends on the existence of an underlying loan agreement, with swap agreements being entered into to stabilize the interest rate of loan agreements. However, an independent swap such as the one being analyzed is not aimed at providing any kind of protection.

The court considered that an over-the-counter swap agreement for a notional amount only, a fictional fixed interest rate and a fictional variable interest rate, with a payment obligation from one party to another based on the difference between the two fictional rates and disregarding the parties' behavior, will be considered a purely random agreement entered into for speculative purposes only and void for being unlawful under article 281 of the Civil Code.

European case law

Judgment of the European Court of Justice, of June 18, 2020 (proceedings C-639/18)

Article 2(a) of Directive 2002/65/EC, on distance marketing of consumer financial services ("**Directive 2002/65/EC**"), defines a distance contract as a contract concerning financial services entered into between a supplier and a consumer under an organized distance sales or service provision scheme run by the supplier, which, for the purpose of that contract, makes exclusive use of one or more means of distance communication up to and including the time the contract is terminated.

Called on to decide whether this concept includes amendments to loans agreements, the court reviewed the degree of protection ensured to the consumer and stated that an agreed amendment solely pertaining to an interest rate would have no relevance to the consumer as a main characteristic of the financial service.

The court ruled that this provision must be understood to mean that an agreed amendment to a loan agreement is not included in the concept of "contract relating to financial services," within the meaning of that provision, when it amends only the interest rate originally agreed, without extending the term of the loan or modifying its amount, the original clauses of the loan agreement provided for the execution of such an amendment or, failing such execution, the application of a variable interest rate.

Judgment of the European Court of Justice, of June 4, 2020 (proceedings C-301/18)

In this case, the Court of Justice was called on to decide whether article 7(4) of Directive 2002/65/EC should be interpreted as meaning that, when a consumer exercises its right to terminate a distance loan agreement with a supplier, that consumer is entitled to receive compensation for the benefit of use of the principal and interest.

The Court of Justice, acknowledging that Directive 2002/65/EC establishes an obligation for the supplier to repay the consumer all sums "received from it" and only those sums, concluded that, subject to certain sums the consumer is required to pay to the supplier under article 7(1) and (3) of Directive 2002/65/CE, no compensation for the benefit of using the principal and interest would be due.

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Cuatrecasas has set up a Coronavirus Task Force, a multidisciplinary team that constantly analyzes the situation emerging from the COVID-19 pandemic. For additional information, please contact our taskforce by email TFcoronavirusPT@cuatrecasas.com. On our website, you can read publications or attend webinars on legal issues arising from the pandemic and the measures adopted to mitigate it. You may also find our publications in Portuguese and Spanish.

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