



LOAN FUNDS

Loan funds and other forms of alternative lending in Portugal

Since the financial crisis, with new restrictions placed on banks and the legacy of non-performing loans (NPLs), one of the main objectives of Governments and authorities in the European Union (“EU”) has been to promote new alternative forms of lending to European companies beyond the banking sector entities. In Portugal, this is even more important in light of the strict legal restrictions imposed by the Portuguese Banking Law (*Regime Geral das Instituições de Crédito e Sociedades Financeiras* or “RGICSF”) on lending carried out on a professional basis, which is generally restricted to banks and other specific financial institutions.

However, several legal developments at the national and European level have broadened the scope of regulated entities that can conduct lending activities, subject to specific requirements. More recently loan funds have been expressly regulated in Portuguese law with the, creation of an important exemption to professional lending activities.

Below, we briefly analyse three alternative forms of granting credit that have been developed in Portugal: **(1) crowdlending platforms; (2) ELTIFs; and (3) loan funds.**

(1) Crowdlending platforms

In 2015, the Crowdfunding Law (*Regime jurídico do financiamento colaborativo*, approved by Law 102/2015 of 24 August) regulated crowdlending platforms (*plataformas de financiamento colaborativo por empréstimo*) for the first time. It created a specific legal framework for internet-based platforms for intermediate lenders and borrowers. As a result, it allows this activity to be carried by more lightly-regulated entities, which are authorised and supervised by the Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários* or “CMVM”). The legislation has tacitly meant that such activities are not considered as professional credit lending by the platform operator.

However, the Crowdfunding Law places significant constraints on the amounts of financing that can be obtained through a crowdlending platform. For example, only projects up to €1 million per offer within the last 12 months, which can be €5 million if the offer is directed only at certain qualified investors. It also places constraints on the investments that can be made by retail individual investors. For example, up to €3,000 per offer and up to €10,000 per year, with certain exemptions.

"The Crowdfunding Law places significant constraints on the amounts of financing that can be obtained through a crowdlending platform."

Additionally, the Crowdfunding Law did not amend the Banking Law to provide an express exemption for persons that provide credit through a crowdlending platform and this can raise doubts as to whether a person might be seen as granting credit on a professional basis through an online crowdlending platform. CMVM Regulation 1/2016 also states that lending through crowdlending platforms does not prevent the application of the licensing rules applicable to persons lending on a professional basis. This creates significant legal uncertainty as to when a person is deemed to be engaging in lending activities on a professional basis when they lend through a crowdlending platform.

These restrictions could be seen as being in line with the main legislative objectives of the Crowdlending Law to promote peer-to-peer lending and investment. However, they imply that the crowdlending alternative is not really an alternative for bigger projects.

(2) ELTIFs

The ELTIF Regulation¹ introduced a new type of harmonised alternative collective investment scheme, the European long-term investment fund or “ELTIF”. Crucially, the ELTIF Regulation expressly defined as eligible investment assets of ELTIFs loans granted by the ELTIF to a qualifying portfolio undertaking with a maturity no longer than the life of the ELTIF (Article 10(c) of the ELTIF Regulation).

“Qualifying portfolio undertakings” were defined in the ELTIF Regulation (Article 11), requiring, among others, that such undertakings must not be admitted to trading on a regulated market or MTF, unless they have a market capitalisation lower than €500 million.

An express exemption was not provided in the Banking Law for ELTIFs that grant loans to qualifying portfolio undertakings. However, considering the legal nature of the ELTIF Regulation (which is directly applicable in EU Member States), it should be understood that ELTIFs are allowed to grant loans under the conditions set out in EU law without triggering a licence requirement under the Banking Law. This is an important factor considering that ELTIFs can make use of the EU passport regime and that they are a harmonised type of alternative investment scheme. An ELTIF established in the EU could therefore grant credit in Portugal under the conditions set out in the ELTIF Regulation.

Furthermore, a collective investment scheme will, in principle, have to be formally established and authorised as an ELTIF. Therefore, it is subject to the regulatory restrictions placed on this specific type of scheme, including the 10% limit on loans granted to any single qualifying portfolio undertaking.

(3) Loan funds

In September 2019, the category of loan funds (fundos de créditos or OIAE de créditos) was introduced into Portuguese law by Decree-Law 144/2019 of 23 September. Loan funds are a specific type of alternative investment fund regulated in the Legal Framework of Venture Capital Funds and Companies² (Articles 5-A to 5-D), which will be allowed to grant loans, as well as acquire performing and non-performing loans held by financial institutions.

The CMVM has recently approved Regulation no. 5/2020, published in Official Gazette on April 27 (“Regulation”), which implements the first amendment to CMVM Regulation no. 3/2015, of 3 November 2015, on venture capital, social

entrepreneurship and specialised alternative investment, in order to regulate the activity of the loan funds.

With the publication of this Regulation, the rules on loan funds enter into full effect. This is an important development in the Portuguese financial legal framework, because, as mentioned above, until now, there were several restrictions on both lending and the acquisition of performing loans, which could be deemed as triggering licensing requirements when carried out on a professional basis. With the new rules, loan funds will benefit from an explicit exemption provided in the Portuguese Banking Law (Article 8(4)(g)) that covers these activities when carried by authorised loan funds. This provides greater legal certainty.

"Loan funds can be established as self-managed corporate entities or as contractual collective investment schemes."

¹ Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds.

² Legal Framework of Venture Capital, Social Entrepreneurship and Specialised Investment, approved in annex to Law no. 18/2015, of March 4 (as amended).

a) Licensing and supervision

Loan funds can be established as self-managed corporate entities (*sociedades de créditos*) or as contractual collective investment schemes (*fundos de créditos*). When managed by a third party (which would be the case for schemes in contractual form), they can be managed by Collective Investment Undertaking Management Companies (*Sociedades Gestoras de Organismos de Investimento Coletivo*) or by Venture Capital Fund Management Companies (*Sociedades Gestoras de Fundos de Capital de Risco*). These entities are authorised and supervised by the Portuguese Securities Market Commission (CMVM).

One aspect that remains unclear is whether a loan fund from another EU Member State is allowed to grant loans in Portugal, considering the new exemption for loan funds under the Portuguese Banking Law. In any event, as in the case of other Member States (e.g., France), EU AIFMs should be able to make use of the AIFMD³ passport rules under the freedom to provide services to establish loan funds in Portugal.

b) Important restrictions

Prohibited activities. Loan funds are subject to some restrictions on their lending activities. In particular, they are prohibited from granting loans to certain specific entities (article 5-C), notably to: individuals, credit institutions, participants/investors in the relevant loan fund, the loan fund's management entity and depositary (including their group entities), and other collective investment schemes. Moreover, loans funds are not allowed to carry out short-selling activities or securities financing transactions, including securities lending, or using derivative instruments (except for hedging purposes) (see Article 5-C(a)).

"Loan funds are allowed to obtain loans with a maturity not lower than the loans to be granted, up to 60% of the fund's total asset value."

Leverage. In terms of leverage, loan funds are allowed to obtain loans with a maturity not lower than the loans to be granted, up to 60% of the fund's total asset value (Article 5-D).

c) Publication of CMVM Regulation no. 5/2020

The loan funds regime entered fully into force with the regulation adopted by the CMVM through Regulation no. 5/2020 of 27 April.

The main changes introduced in the Regulation relate to the ways loan funds may grant credit to legal persons, in compliance with the rules set out in Articles 5-A to 5-D of the Legal Framework of Venture Capital Funds and Companies.

In particular, the Regulation sets out the requirements for the portfolio composition, the rules for exposure and analysis of credit risk, as well as the duties to be fulfilled by loan funds in their relationship with borrowers.

³ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers.

"After the first twelve months of activity, the loan fund's portfolio must be sufficiently diversified, with a credit limit per entity (including group of entities) of 20% of the fund's total assets."

Loan funds portfolio. The loan funds portfolio may include:

- i) claims arising from loans granted by the fund (individually or within a syndicate of banks) or acquired by the fund from banks or third parties, provided that their maturity does not exceed the life of the fund;
- ii) liquidity⁴, up to a maximum limit of 20% of the fund's assets from the first six months of its activity;
- iii) other assets that arise from the satisfaction of credits or that are demonstrably necessary to maximize their satisfaction (e.g., real estate assets resulting from execution processes).

Risk concentration limits. The Regulation provides that after the first twelve months of activity, the loan fund's portfolio must be sufficiently diversified, with a credit limit per entity (including group of entities) of 20% of the fund's total assets.

Experience. The loan fund's management entity must include at least one member with experience in activities of lending and credit risk management and evaluation.

Credit risk analysis and control, stress tests.

The fund's management entity must establish a risk management system that covers lending activity, including (i) criteria for selection of credits and eligibility of debtors, (ii) procedures for approval of credits, (iii) policies for management of guarantees, (iv) procedures for management of situations of default, as well as, (v) quarterly procedures for monitoring credits and conducting stress tests.

In this respect, it should be noted that in the case of a credit granted by the loan fund within a banking syndicate, qualitative and quantitative information on borrowers may be collected by another participant in the banking syndicate, including a credit institution of the same group as the entity responsible for managing the loan fund.

Duties vis-à-vis borrowers and annual information.

The Regulation states that the management entity must, in particular:

- i) provide borrowers with information in writing on the services provided, the risks involved and the associated costs; and
- ii) ii. comply with the banking rules on lending, with regard, in particular, to (i) the duty of secrecy, (ii) the rules on interest rates and other costs, (iii) and the counting of maturities, remuneratory interest, capitalisation of interest and default of the debtor.

⁴ For this purpose, liquidity may consist of bank deposits which can be mobilised at any time, certificates of deposit, money market or short-term money market investment units and financial instruments issued or guaranteed by a Member State with a residual maturity of less than 12 months.

In addition, the management must disclose to the CMVM, by the end of February of each year, certain information on the credits and risk positions of the loan fund.

Conclusion

With the publication of the Regulation on 27 April, the legal framework on loan funds came into full force. As has already happened in other European Union countries, this framework contributes to the diversification of financing solutions available to the Portuguese economy, both through the granting of credit to companies and through the acquisition of credits generated by financial institutions (namely NPLs). This allows for better complementarity between the banking sector and the venture capital and securitisation sectors. ■

"As has already happened in other European Union countries, this regime contributes to the diversification of financing solutions available to the national economy."