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Participating Loans' Legal Framework

On *January 12th, 2022, Decree-Law No. 11/2022 was published, introducing and allowing participating loans.*

As mentioned in the preamble of the aforementioned legislation, having been identified the need to promote the capitalization of companies by increasing their equity levels, this Decree-Law aims to enable corporate financing through the introduction of the concept of participating loans - i.e., loans whose remuneration and reimbursement are related, although not exclusively, to the results of the borrower. For this reason, participating loans consist of quasi-equity instruments that may be booked, totally or partially, as equity, improving the Company's financial situation.

A participating loan is a credit agreement for consideration, in the form of a loan or in the form of debt notes, the remuneration and repayment or redemption of which depend, even if partially, on the results of the borrower's activity and the outstanding amount of which may, provided certain conditions are met, be converted into equity capital of the borrower. Additionally, participating loans are considered equity for the purposes of corporate legislation, whenever the respective remuneration depends on the borrower's results and the respective reimbursement or repayment depends on amounts distributable in compliance with the criteria foreseen in articles 32 and 33 of the Portuguese Companies Code.

The possibility of granting participating loans is relatively restricted to the following entities: (i) credit institutions and financial companies; (ii) specialised alternative credit investment, venture capital and social entrepreneurship funds; (iii) securities investment companies to develop the economy; (iv) the Capitalisation and Resilience Fund ("Fundo de Capitalização e Resiliência"); and (v) other entities that are qualified to grant credit on a professional basis. On the other hand, only non-financial companies may take such loans.

Among the characteristics of participating loans, it should be noted that they are always for consideration, with the remuneration being indexed to a share in the borrower's profits fixed by agreement, and may also have an additional interest rate component.

Furthermore, on one hand, the borrower may repay the participating loan or redeem the debt notes, at any time, at the nominal value, accrued with the remuneration contractually agreed or under the conditions associated with the debt notes. On the other hand, the lender may only request full or partial repayment of the participating loan, including any remuneration due, provided that this is provided for in the contract or in the terms of issue.

Considering that the remuneration and reimbursement of this type of loans are indexed to the borrower's results, they are prohibited when: (i) the borrower's equity is or would, by virtue of the payment, become less than the sum of the share capital and reserves; and (ii) the profits of the year are required to cover losses carried forward or to form or reinforce the reserves imposed by law or the articles of association.
While a participating loan agreement is in force or while the debt notes are not repaid, the borrower may not alter the profit-sharing conditions established in the bylaws, grant privileges to existing shareholdings, reimburse shareholder loans, ancillary or supplementary payments, redeem shareholdings or decide to reduce its share capital, except with the express authorisation of the lender.

Finally, as it results from its nature, the lender has the right to convert the participating loan or debt notes into equity in the share capital of the borrower in the following cases (i) if repayment has not occurred in full, after the maturity period fixed by the parties in the *agreement or in the conditions of issue of the debt notes; (ii) if the borrower has not paid the remuneration due for more than 12 months, consecutive or not, within a certain period fixed in the agreement or in the conditions of issue of the debt notes (iii) if the borrower's management body does not provide the lender with proof of approval of the accounts and deposit at the Commercial Registry within 12 months after the legal deadline for this; and (iv) other situations that may be established in the relevant contract.*

This conversion of the participating loan or debt notes into equity in the share capital may be effected through an increase in the borrower's share capital to be subscribed by the lender (which may be preceded by a prior reduction of the share capital to cover losses), in which case the shareholdings of the borrower's shareholders who do not participate in the capital increase are diluted. Alternatively, if the bylaws and the law so permit, the lender and borrower may establish in the agreement that the lender has an enforceable right to convert the participating loan into equity in the share capital of the borrower, in the circumstances and under the terms expressly defined by the parties.

Although the legal framework is quite extensive, it allows a wide margin the parties to negotiate the terms of constitution, development and execution of this form of financing. This new legal framework entered into force on January 13th.

For any further questions on this legal framework, please do not hesitate to contact us.

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