

16<sup>TH</sup> OF FEBRUARY 2022

## **LEGAL FRAMEWORK FOR PARTICIPATORY LOANS**

### **DECREE-LAW NO. 11/2022, OF JANUARY 12**

Last January 12th, Decree-Law no. 11/2022 was published on *Diário da República*, establishing the legal framework for participative loans, whose main features we highlight in this newsletter.

#### **What are Participatory Loans?**

As the name implies, it is a loan granted in the form of a loan or debt securities, distinguished from traditional loans by the fact that its remuneration and repayment or amortization depends, even if only partially, on the result of the borrower's activity, with the possibility of being converted into capital stock.

Unlike traditional loans, participatory loans can be counted as equity of the borrowing companies.

#### **Who can grant and receive equity loans?**

The granting of equity loans or the underwriting of equity loan debt securities can only be carried out by the following entities, as lenders: **(i)** credit institutions and financial companies; **(ii)** specialized alternative credit, venture capital, and social entrepreneurship investment funds; **(iii)** securities investment companies to promote the economy; **(iv)** Capitalization and Resilience Fund; and **(v)** other entities qualified to grant credit on a professional basis.

On the borrowers' side, only commercial companies in the non-financial sector can contract equity loans. In the event of their insolvency, equity loans are considered subordinated claims, ranking above the claims of the partners and other persons especially related to the borrowers.

#### **Conditions and purposes**

The legal regime in question establishes, as an essential condition for contracting

participatory loans the existence of a prior express and favourable resolution of the borrower's shareholders meeting, the approval by simple majority being sufficient.

The purpose of these loans, to be fixed in the respective contract or in the conditions of issuance of debt securities, may consist of: **(i)** in investment financing, **(ii)** in the reinforcement of working capital or **(iii)** in the repayment of previous debt; or **(iv)** any other agreed purpose consistent with the corporate purpose or investment policy of the lender and borrower.

### **Remuneration**

The remuneration of participatory loans is mandatorily indexed, exclusively or partially, to a share in the borrower's results, as agreed upon by the parties, and may also have an additional interest rate component, independent of the results achieved by the borrower.

The parties may agree on a grace period in the equity loan contract.

### **Reimbursement**

The borrower may repay the equity loan or redeem the debt securities at any time, at nominal value, plus contractually fixed remuneration or at the conditions associated with the debt securities.

The remuneration is calculated with reference to the amount that would be due by the beginning of the quarter in which the reimbursement occurs, taking as a reference the respective financial statements that allow the results to be determined.

### **Conversion into capital stock**

Without prejudice to more demanding conditions or other situations provided for by the parties, the diploma gives the lender the right to convert the participatory loan into share capital of the borrowing company when, namely **(i)** the refund has not occurred in full, **(ii)** the borrower has not paid the remuneration due for more than 12 months, or **(iii)** if the borrowing company does not provide the lender with proof of approval and filing of the annual accounts.

## **Conclusion**

This legal regime, which came into force the day after it was published, introduced an innovative figure in the Portuguese legal system, having been preceded by European guidelines concerning the need to promote the capitalization of companies.

On the borrowers' side, this new loan modality may bring benefits from an accounting and financial point of view, increasing the level of equity capital. As for the lenders, participatory loans may prove to be advantageous in the business of banks and venture capital funds, due to the additional guarantees guaranteed by this new legal figure.

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**PARES | Advogados** is available to provide information on this and other topics in a more adequate and suitable way to the reality of each client and is able to help its clients on any topic regarding the Legal Framework for Participatory Loans.

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