

# NEWS

## BANKING & FINANCE / CAPITAL MARKETS

### Index

Editorial	1
MIFID and Know Your Customer Rules	2
Financial Pledge, Appropriation and Attribution of Voting Rights	2/3
These are the Times - A Few Remarks on the increased supervision Powers of the Bank of Portugal	3
In Brief	4

In this second edition of our Newsletter we approach the most significant legislation changes occurred between October 2007 and April 2008, pursuing the purpose established when our newsletter was initially published: to reveal our practice in this segment, and pass on, whenever suitable, our critical perspective in relation to the most relevant matters and developments for the financial activity in Portugal, both in the banking and capital markets activity and in result of the insurance activity.

Six months after our last Newsletter and after the first quarter of 2008, the recognition of the impact that the financial context of the main international markets have had in the Portuguese market is inevitable. In fact, and still as a result of the financial crisis originated in the North American markets, the current slowing down of the flow of the major financial transactions was to be expected. However, we are also witnessing several market developments aiming at, dynamically and creatively, substituting many of those transactions for more diverse and of smaller dimension transactions, targeting other sort of goals and always purporting to allow the access to available liquidity sources. The truth is that the Portuguese market (or rather, the market of debt issued out of Portuguese market) is giving signs that it does not intend to stop, instead it is evidencing an adjustment ability to the current market circumstances whether through the implementation of new products and solutions, whether through the exploitation of existing structures for innovative purposes. One must stress, therefore, that throughout the semester to which this Newsletter refers, the implementation of two new programmes of Portuguese Covered Bonds, confirms definitely this product within the context of the market for bond issuances made out of Portugal. Additionally, the launching of exchangeables, proves once more the creativity of Portuguese issuers, even within the context of notably adverse market conditions.

It is in this transition and reflection period of the markets that we highlight in

## EDITORIAL

*Pedro Cassiano Santos*

this Newsletter information related to: (i) the Know your Customer rules resulting from the recent transposition of the Markets in Financial Instruments Directive (MiFID), which have required an increase in the sophistication of the financial intermediation activity; (ii) the continuous challenges emerging from the provisions of the Portuguese Securities Market Code on the "acting in concert" over companies; and (iii) the reinforcement of Bank of Portugal's supervision authority within the challenges posed by Basel II. Additionally, we also briefly summarize other legislative innovations which occurred from October 2007 to April 2008 and point out some aspects that await approval or publication at anytime. We hope this Newsletter corresponds to the expectations of its addressees, and we remain available to take all comments or suggestions you may have and wish to pass on to us, which may be sent to [pcs@vda.pt](mailto:pcs@vda.pt). I thank you in advance for any comments which may be sent in respect to this second issue and take this opportunity to also thank the various comments received in respect to our previous issue, all of which we see as an encouragements to our continued work of issuing this Newsletter.

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# MIFID AND KNOW YOUR CUSTOMER RULES

Ana Rita Almeida Campos and José Luís Andrade

Index

The entry into force of the Markets in Financial Instruments Directive (“**MIFID**”) imposed new and stricter obligations upon the financial intermediaries, notably, the elaboration of client investment profiles and the execution of adequacy tests.

The financial intermediaries’ obligation of complying with *Know Your Customer* (“**KYC**”) rules, provided for in MIFID, involves the classification of clients in one of the following categories:



Once the client has been classified in one of the alluded categories, the financial intermediary shall adopt the inverted proportionality principle, in accordance with which the lesser the client’s

knowledge and experience about the subject in question, the greater the comprehensiveness of the information to be provided.

MIFID imposes that the results of the KYC activity in respect of each client are subsequently used when evaluating the transaction, which is more appropriate to said client’s knowledge and experience.

Nonetheless, in order to avoid the financial intermediary entering into unnecessary and inadequate costs in light of the client’s specific investment request, MIFID classifies the financial instruments in two different groups:

- Complex (such as *warrants*, derivatives, securities detached rights, etc) and;
- Non-complex (such as stock, bonds, commercial paper, etc).

In accordance with the criteria set forth in MIFID, the financial intermediary is, these days, and pursuant to articles 314 and the following of the Portuguese Securities Code, obliged to conduct tests which will determine the adequacy of the

proposed transaction to the profile of the investor in question:

- *Appropriateness test*: questionnaire which is to be conducted in relation to execution-only investment services and which relies on the assessment on the client’s experience about the kind of instrument or service to be provided for;
- *Suitability test*: questionnaire which is to be conducted in relation to portfolio management or investment advice, which requires the assessment of additional information pertaining to the client’s financial situation and investment goals. The Suitability test must be conducted in respect of all clients regardless of their category.

Both the inverted proportionality principle and the adequacy tests have triggered a global restructuring of the financial intermediaries’ activity, with practical results that no doubt enable a stronger and more efficient protection of their clients’ interests.

## FINANCIAL PLEDGE, APPROPRIATION AND ATTRIBUTION OF VOTING RIGHTS

Helena Vaz Pinto and Orlando Vogler Guiné

The coming into force of article 11 of Decree-Law no. 105/2004, of 8 May 2008 - which rules the financial pledge - introduced the possibility of the pledgor appropriating the pledged asset in case of default. Under said article 11 and subject to the conditions and within the limits therein, the banks may thus agree with their clients that, in a default scenario, they will acquire property over the pledged assets.

Consider, for instance, that company A grants a financial pledge in favour of Bank B over a

portfolio of shares which includes a substantial holding (greater than 2 per cent of the voting rights) in company X, listed on Eurolist by Euronext Lisbon.

Even if it is agreed by the parties that the voting rights inherent to the shares in company X will continue to be exercised by A, given the fact that Bank B may acquire title over the shares in an enforcement scenario, such possibility relates to the “transferability” of such shares, and it may be asked if such agreed possibility is assumed to

be an “acting in concert instrument” over that company X under the terms of no. 4 of article 20 of the Portuguese Securities Code (“**PSC**”) and thus if such voting rights are attributable to Bank B under the terms of nr. 1, paragraph h), of the same article.

continue page 3



The assumption resulting from the above mentioned no. 4 targets certain types of situations that many times are used as formal “cover” for an agreement whereby its parties actually act in concert in respect of a given public company. Typically, in accordance with Portuguese Securities Market Commission’s (CMVM) understanding, this provision targets situations such as pre-emption or put-option agreements, which, in consequence, are subject to a prior scrutiny before that authority.

It should be noted, however, that the beneficiary of any type of security, including a pledge, shall be able to foreclose that security in a default scenario, and thus the parties to a security agreement usually agree on the terms of foreclosure. Taking into account that appropriation is a type of enforcement currently permitted under Portuguese law in respect of financial pledges granted to certain entities, namely to Banks, naturally will such entities resort to such possibility and foresee it in the pledge agreements

entered into in their favour. But for the same reason it shall be concluded that, under a pledge, the eventual future transferability of the pledged shares, including to the pledgor, does not serve any “acting in concert” purposes. That transferability aiming only at security enforcement purposes, shall not be comprised by the aforementioned assumption set forth in the PSC and therefore it does not seem that any prior scrutiny by the regulatory authority shall be required in connection thereto.

Index

## THESE ARE THE TIMES - A FEW REMARKS ON THE INCREASED SUPERVISION POWERS OF THE BANK OF PORTUGAL

Paula Gomes Freire and Tiago Correia Moreira

Decree-Law no. 1/2008, of 3 January 2008 (“DL 1/2008”), has introduced certain changes to the General Regime of Credit Institutions and Financial Companies (*Regime Geral das Instituições de Crédito e Sociedades Financeiras* – “RGIC”). The main purpose of this new legislation is the introduction of mechanisms that are more effective in the protection of clients to whom financial services are rendered. For the pursuit of such objective the supervision, decision and sanctioning powers of the relevant competent supervising authority – the Bank of Portugal – were increased.

The changes introduced to RGIC are essentially focused on three main areas: (i) increased duties for credit institutions, (ii) increased rights for clients and the consequent (iii) increased powers of the Bank of Portugal.

We would start by noting that the introduced changes are made in the context of further regulatory densification of the financial system which takes its inspiration from the views taken by wise men on these matters – the Basel Committee on Banking Supervision. With the adoption of Basel II, this Committee is suggesting, under its set of principles known as pillar II that the banks should be subject to a transparent and effective supervision system. This is the context under which we will analyse the

main changes that were introduced.

In respect of the **increase on the credits institutions’ duties** RGIC was amended so as to ensure that (i) the technical skills of the credits institutions are suitable to maintain conditions of quality and efficiency and that (ii) the scope of the performance duties is enlarged both in respect of the relations with clients and with other institutions. Furthermore, the information duty towards customers to which these credit institutions are subject to may, from now on, be subject to mandatory rules to be issued by the Bank of Portugal in respect of the terms and conditions of the agreements, the non compliance of such information duties representing a punishable misdemeanour procedure. Moreover, two new provisions were added to RGIC relating to the implementation of conduct codes by the credits institutions (in relation to which the Bank of Portugal may issue instructions) and the submission of the credits institutions to general rules on advertising.

As to the amendments introduced on **the increase of the customers’ rights**, we would highlight the fact that the interests which, from now on, are to be borne in mind by the management bodies shall necessarily have to include all those pertaining to the customers in general. Of further relevance is

the addenda introduced, pertaining to customers’ claims, where the possibility for customers to file claims directly with the Bank of Portugal is expressly provided for together with the general principles by which such claiming procedures must abide. All the amendments and addenda mentioned above shall clearly translate into a **strengthening of the Bank of Portugal supervision authority**, *maxime* through the amendment of the rules which provide for a general supervision skill aimed at ensuring compliance with the conduct rules provided for in the RGIC and in complementary regulation, being the Bank of Portugal notably able to issue recommendations and specific instructions, as well as to apply penalties and any other accessory charges. Accordingly, it should additionally be mentioned that it is now expressly provided for that, in the exercise of its supervision skills, the recommendations and instructions to be issued by the Bank of Portugal must be specific, something that clearly means that a more interventionist attitude is now required from the supervision authority. *Sign of the times or a mere (coincident) legislative evolution?* In any event, the financial world will only benefit from these changes if the strengthening of the supervision actually means better supervision. These are the times. This is the challenge.

Index

## ALREADY PUBLISHED...

### Financial Market – Consultancy Activity

Decree-Law no. 357-B/2007, of 31 October 2007, partially implements in Portugal Directive no. 2004/39/EC, on markets in financial instruments, and Directive no. 2000/12/EC relating to the taking up and pursuit of the business of credit institutions. This Decree-Law establishes the legal system applicable to companies whose exclusive scope is to render consultancy services in investment in financial instruments and to receive and transmit orders on behalf of others related with financial instruments. The new rules aim at guaranteeing that those companies meet the requirements needed for them to qualify as investment companies and benefit from the "single passport". It must also be stressed that, as investment companies, the activity of the consultancy services' companies is now subject to the previous authorisation of the Portuguese Securities Market Commission (CMVM).

### Collective Investment Entities

Regulation of CMVM no. 7/2007, of 9 November 2007, is a result of the impact of Directive no. 2004/39/EC, of 21 April 2004, on markets in financial instruments ("MiFID"), on collective investment entities and correspondent management companies and depositaries activity. It implements the principle in accordance to which the financial intermediary should not only know its client but also supervise the adequacy of the relevant services, operations and financial instruments according to the client's personal circumstances. It also implements the new rules on clients' classification which imply that the judgement on the adequacy of a certain financial instrument for the clients is assumed primarily by the financial intermediary.

### Special Market for Public Debt – MEDIP

On 22 November 2007, Regulation of CMVM no. 6/2007 on the Special Market for Public Debt (MEDIP) entered into full force and effect revoking Regulation of CMVM no. 22/2000, of 30 June 2000. This new Regulation no longer establishes the obligation to exchange information between MEDIP and other regulated markets in which the same securities are admitted to negotiation. Instead, such information exchange shall be agreed between the managing entities, in accordance with what is provided under article no. 218 of the Portuguese Securities Code, amended in order to implement the MiFID.

### New Foreign Currency Settlement System

Interbolsa has introduced on the market, since 3 March 2008, a new Foreign Currency Settlement System (SLME) in order to complement the settlement services provided by it in what concerns the settlement of the securities operations. This new system allows interest payments and redemptions in foreign currencies (American dollars, pounds sterling, yens and Swiss francs) and the settlement of exchange operations executed in such currencies in Euronext Lisbon.

### Unfair Sales Practices

Decree-Law no. 57/2008, of 26 March 2008, on unfair sales practices, which entered into force on 1 April 2008, establishes a general prohibition of unfair sales practices which modify consumers' economical behaviour, including unfair advertising, and implements Directive no. 2005/29/CE, of 11 May 2005, in the Portuguese jurisdiction. This general prohibition is appended with provisions on the two most common types of unfair sales practices: the misleading sales practices and the aggressive sales practices, the fair or unfair character of such practice being determined with reference to the average consumer.

### Housing Savings Accounts

Decree-Law no. 54/2008, of 26 March 2008, sets forth that, in what concerns housing savings accounts, tax penalties for withdrawals made for purposes

other than those permitted by law will no longer be charged in respect of amounts resulting from deposits made up until 31 December 2003 as the period for the liquidation of such penalties, i.e. 4 years, has lapsed.

It further establishes that the provisions of article 6, paragraph 1, of Decree-Law no. 27/2001, of 3 February 2001, (which impose the cancellation of accrued and credited interest amounts whenever the housing savings account's balance is used for a purposes other than those permitted by law) may only apply, even if not in a mandatory manner, by virtue of withdrawals of funds resulting from deposits made after 1 January 2004, the cancellation, by banks, of accrued and credited interest amounts being forbidden in respect of deposits made up until 31 December 2003.

### Reporting obligations of foreign institutions branches

The Notice of the Bank of Portugal no. 2/2008 amends Notice no. 12/91, which determines the disclosing of accounting documentation of branches of credit and other foreign financial institutions established in Portugal, simplifying such procedure. Accordingly, branches of credit and other financial institutions with head office outside the EU which do not apply the rules and accounting methods recognized as equivalent to the ones used in the UE, are required to disclose the annual accounts and relevant management report of the institution they belong to, and, if applicable, its consolidated accounts and the relevant consolidated management report as well as the reports elaborated by the individual in charge of such accounts control, in one of the local major newspaper where the branch is established or in Bank of Portugal's website.

## SOON...

### Residential Mortgage Credit Facilities and Bank Deposits

The Council of Ministers has approved on 3 April 2008 a decree-law which amends (i) Decree-Law no. 51/2007, of 7 March 2007 (on credit institutions' commercial practices concerning residential mortgage credit facilities); (ii) Decree-Law no. 430/91, of 2 November 1991 (on the deposits agreements); and (iii) Decree-Law no. 171/2007, of 8 May 2007 (on the rounding of interest rates for leasing, lease-purchase, factoring and other such agreements).

As concerns **residential mortgage credit facilities**, a legal equivalence between the reference for the interest rate calculation and the index basis is ensured, and as concerns **bank deposits**, the transparency of banking practices regarding interest payable on deposits and the harmonization of all credit institutions' procedures when handling deposits is emphasized, thus simplifying the comparability of the institutions' common practices. At last, an additional adequacy regarding the reference period for the interest rate calculation within company facility operations is allowed, thus allowing, should companies so decide, in agreement with the lending banks a larger adequacy of the regime to the specific characteristics of their facility.

### Reform of the Land Registration Framework

The Portuguese Government presented in February 2008, the proposed reform of the land and registration framework which is expected to enter into force by the end of the year. The proposed framework: (i) establishes the creation of "*Balcões Únicos*" (sole desks) (ii) the general simplification of procedures, as well as the elimination of unnecessary formalities (iii) the creation of new on-line services and (iv) the establishment of a unique price for each procedure. With the establishment of "*Balcões Únicos*", (a) the obligation to execute a public deed regarding real estate property acts is eliminated and all acts in relation thereto may be executed by means of an authenticated private document, and (b) lawyers, commerce and industry chambers, notaries and solicitors shall promote the registry regarding the acts in which they participate in relation to real estate properties.