



Banking Regulation

Second Edition

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Published by Global Legal Group

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Mozambique

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Introduction

An analysis of the Mozambican banking sector – or of any specific sector – needs to take into account the *momentum* the country is currently enjoying. To this end, significant discoveries of minerals resources and hydrocarbons have boosted Mozambique’s visibility worldwide, and as a result foreign investment is increasing and the macro-economic figures – including an average GDP growth of 7% – are impressive.

In this context, opportunities are expected for the banking sector, notably in what concerns services to energy and natural resources companies, as well as to downstream and upstream industries providing services to these mega projects. Possibly as a result of a (decreasing) strong dependence from donors, Mozambique has been working towards achieving a culture of compliance with international standards, figuring as a *case study* amongst African countries.

The above environment has led to Mozambique to permanently improve its legal system, in an attempt to keep it up to date with the transformation of its economy, an effort which requires permanent monitoring and the capability to anticipate legal needs. There is still a long path ahead, but several milestones have been achieved and the country’s efforts in this respect have been significant.

Despite the limitations on the Mozambican banking system still being evident, there is potential for growth and it is well worth noting that the Bank of Mozambique’s president, Ernesto Gove, has been recently distinguished as Africa’s Best Central Bank Governor, and awarded “Central Bank Governor of the Year 2015”, by *The Banker*.

Banking sector overview

According to KPMG’s survey prepared for the Association of Mozambican Banks (October 2014):

- the total assets for the banking sector registered a 19% growth from 2012 to 2013 (totalling 281,168,203.00 meticaís);
- loan portfolios registered a 29% growth from December 2012 to December 2013 (totalling 34,391,653,00 meticaís); and
- the ratio of loans to deposits increased from 67% in 2012 to 72% in 2013.

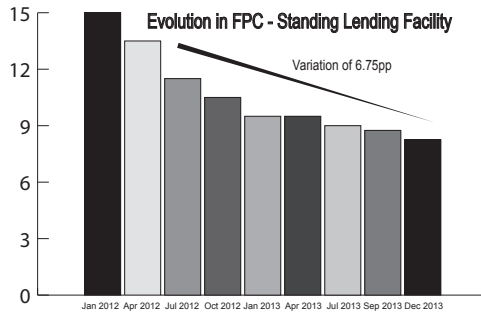
Indeed, the banking sector in Mozambique continues to be dominated by the top three banks (see pie chart below): Banco Internacional de Mozambique (Millennium Bim); Banco Comercial e de Investimentos (BCI); and Standard Bank, together hold more than 70% of the total market of loans and deposits.

Total Activos / Total Assets



Pesquisa sobre o Sector Bancário / Banking Survey 2014 |

Low competition should be one explanation – among others – for the high average lending rates offered by commercial banks, which seem to only timidly keep pace with the 15% fall of the Standard Lending Facility, performed by the Central Bank of Mozambique, from January 2012 to December 2013.



Description	Dec 2010	Dec 2011	Dec 2012	Dec 2013
30 days	14.57%	14.45%	11.45%	11.20%
60 days	15.57%	15.45%	12.20%	11.95%
90 days	16.69%	16.56%	13.34%	13.09%
1 year	18.35%	18.23%	15.04%	14.79%

Source: Bank of Mozambique

In effect, smaller financial institutions are struggling against this trend and gearing themselves up to take advantage of the increased opportunities, namely by partnering with international and regional financial players who, on their side, seem to view the purchasing of shareholdings in Mozambican existing financial institutions as a suitable strategy to enter the Mozambican financial market.

In 2014, the South African Nedbank acquired a 36.4% stake in the Mozambican Banco Único while the Portuguese Banco Montepio acquired the Mozambican Banco Terra (partnering with Rabobank). Both transactions included a component of share capital increase.

Back in 2011, the Portuguese Banco Espirito Santo (now called Novo Banco) acquired a 25.1% stake in Mozabanco and, in 2013, raised its stake to 49%, in a process that was also combined with share capital increases.

Mozambique presents several challenges to the development of traditional banking systems and to spread the utilisation of banking across the community, as currently the banking utilisation rate is at 20%. With an area of about 800,000 km², it is the 35th largest country in the world. Given its infrastructure development, the mobility of the population is precarious – there is, therefore, significant geographical dispersal.

In this respect, Mozambique has not departed from the African trend: mobile banking is seen as the most adequate mechanism to work around these limitations.

Banks are struggling to implement a policy of expanding and developing their electronic networks and mobile banking services. Namely:

- general mobile banking services enabling the performance of a wide range of interactions with the banks, and their products and services; and
- Credelec – an application that allows the purchase of power (electricity) on a pre-pay basis (also available from ATMs).

The figures are impressive: according to the information disclosed, Millennium Bim increased banking transactions in this sector in 2013, from 600,000 to 3,000,000.

The existence of BCI's *Tako Móvel* should also be pointed out, however – a mobile-to-mobile bank transfer service, enabling mobile phone users to make cash withdrawals from automatic cash machines without the use of a bank card – in fact, this service allows customers who do not have a bank account to also have access to and be provided with basic financial services.

Legal framework

The Mozambican legal system can be generally described as mature. Its foundations derive from the Portuguese legal system (without prejudice to the applicable adjustments to the Mozambican environment and culture). Thus, it is based on the continental civil law framework, without prejudice to some common-law influence, particularly from South Africa (and note that Mozambique is part of the Commonwealth). Given the legal influence of Portugal, Mozambique is also indirectly influenced by European Union law.

Legislation and regulation on banking matters is wide and frequently updated. We would outline the following legislation:

- Law on Preventing and Combating Money Laundering and Terrorism Financing: Law nr. 14/2013, of 12 August;
- Foreign Exchange Law: Law nr. 11/2009, of 11 March;
- Foreign Exchange Regulation: Decree nr. 83/2010, of 31 December;
- Credit Institutions and Financial Companies Law: Law nr. 15/99, of 1 November, as amended by Law nr. 9/2004, of 21 July;
- Credit Institutions and Financial Companies Regulation: Decree nr. 56/2004, of 10 December, as amended by Decree nr. 31/2006, of 30 August;
- Statute of the Bank of Mozambique: approved by Law nr. 1/92, of 3 January;
- Securities Code – Decree-Law nr. 4/2009, of 27 July;
- Investment Funds Regulation – Decree nr. 54/99, of 8 September, as amended by Decree nr. 36/2005, of 29 August;
- Venture Capital Funds Regulation – Decree nr. 56/99, of 8 September;
- Notice nr. 3/GBM/2012, of 13 December, of the Bank of Mozambique (Basel II); and
- Notice nr. 18/GBM/2013, of 31 December, of the Bank of Mozambique – International Bank Account Number.

Within this wide framework, we view as specific areas with potential for developing the Mozambican market, the following regulations, on (i) foreign exchange, (ii) Basel II, (iii) capital markets, and (iv) investment funds and venture capital funds.

Foreign Exchange Regulation

The Foreign Exchange Regulation has mainly addressed three topics: liberalisation; strengthening of the local currency (metical); and the role of the banking system.

Liberalisation was essentially achieved by broadening the category (not the regime) of Current Operations – i.e. payments or collections in foreign currency not connected to capital transfers, which are exempted from the previous authorisation of the Central Bank of Mozambique, and only being subject to registration. Current Operations include, according to the Foreign Exchange Regulation:

- (i) payments from residents – imports of goods and services, other import payments (e.g., payments due in connection with the utilisation of patents, copyrights, franchising rights, trademarks and other industrial and intellectual property rights) and other payments from residents (e.g., court charges due abroad);
- (ii) earnings of residents – exports of goods and services and other export payments (e.g., earnings from rental and utilisation of patents, copyrights, franchising rights, trademarks and other industrial and intellectual property rights);
- (iii) transfer of earnings – transfer abroad of earnings resulting from capital operations previously authorised by the Central Bank of Mozambique, notably: (a) foreign and direct investment, in the form of profits or dividends distribution; (b) portfolio investment, in the form of interests, dividends, or capital gains; (c) loans, including shareholders' loans, in the form of interests; and (d) other forms of capital investment;
- (iv) current transfers – such as money donations, maintenance payments and remittance of monies for family expenditure; and
- (v) transfers related to insurance agreements – particularly those executed between residents and non-residents in the context of short-term (less than one year) insurance agreements.

From an investor's perspective, the key notion to retain is that, generally, provided that capital investments in Mozambique are registered – e.g., share capital – or authorised – e.g., shareholders' or third parties' loans – by the Central Bank of Mozambique, the remittance of the respective earnings falls under the category of Current Operations and, therefore, are only subject to registration.

Strengthening of the metical was achieved by two means:

(i) *Duty of repatriation*

In what concerns the duty – applicable to resident entities – of the repatriation of earnings resulting from the export of goods, services and foreign investment, the payment of the price and the collection of the income shall be made through bank transfer, converted in national currency in the beneficiary bank account, according to the intermediary bank's exchange rate at the date of the actual repatriation. Part of the earnings in foreign currency can be allocated to (i) retention, up to the limit of 50%, in a national account of the exporter or investor, and (ii) amortisation of loans in foreign currency borrowed from the national banking system.

Importantly, the Central Bank of Mozambique may, on a case-by-case basis and under defined conditions, exempt the resident entity from the duty of repatriation and authorise the retention of part of the earnings abroad.

(ii) *Limitation on foreign currency bank accounts*

The opening and operation of local currency bank accounts by non-residents is subject to prior approval from the Central Bank of Mozambique. As such, the request shall be made simultaneously with the request for approval of a forex or capital operation. As to residents, opening and operating foreign currency bank accounts is also subject to prior approval from the Central Bank of Mozambique. In both cases, limitations are established in respect of the sources for foreign currency accounts, and also in respect of cash withdrawal (limited to \$5,000).

In order to strengthen the banking system all foreign exchange operations that entail payments or cross-border cash-flows shall, generally, only be executed through bank transfers from and to banks duly authorised to operate in Mozambique.

Additionally, operations exempted from previous authorisation of the Bank of Mozambique – in particular, Current Operations – must be registered with the relevant financial intermediaries. Such registration comprises: (i) all information of the foreign exchange operation, namely, the parties (and their capacity), the nature, the amount and the purpose of the transaction; (ii) the electronic or (only if the latter is not possible) manual processing of the information; (iii) the archive of copies of the supporting documents; and (iv) the issuance of an exchange registration bulletin, in physical or electronic format. In a nutshell, the above means that the legality control of forex transactions was transferred to the banking system.

Basel II

Compliance with Basel II was ensured in Mozambique by the enactment and implementation of Notice nr. 3/GBM/2012, of 13 December 2012, of the Central Bank of Mozambique. Indeed, the Notice established the scope and timing for the introduction of amendments to the country's prudential legal framework and to the rules of capital adequacy, resting on three pillars:

- Pillar I: minimum capital requirements to cover credit, operational and market risks;
- Pillar II: Supervisory Review Evaluation Process (SREP) and Internal Capital Adequacy Assessment Process (ICAP); and
- Pillar III: market discipline.

The Notice further provided that for the purposes of the implementation of Pillar I, identified above, the Central Bank of Mozambique should issue additional rules, *inter alia* concerning: (i) the implementation of the simplified standard model for the calculation of risk-weighted assets; (ii) the adoption of the (so-called) Basic Indicator Approach, Standardised Approach or both, for the calculation of capital requirements regarding operational risk; and (iii) the calculation of capital requirements to cover market risks.

The Central Bank of Mozambique approved such additional Notices during 2013. As from January 2014, credit institutions are required to report the relevant prudential information exclusively in accordance with Basel II, 2014 thus being considered year 1 of Basel II in Mozambique.

In light of the above and how the banking system reacted and adjusted, it is fair to say that, currently, the Mozambique banking system is working under a standard legal framework that is more easily perceived – and able to be relied upon – by (national and) foreign investors.

Capital markets

Capital markets are still at an early stage in Mozambique, at various levels (financially, education-wise and legally) and therefore once the legal setting and playing field has been set, market participants could be challenged to approach and explore this route.

Securities Code

The core statute is, or should be, the Securities Code, comprised of 157 articles (which is relatively low when compared to the hundreds of articles (one could say, too many...?) in securities laws and codes across the EU or the US, for instance). It essentially regulates securities themselves, listing and trading on the stock exchange and public offers.

We may summarise the most relevant contents as follows:

- Issuance, form of representation (including the possibility of dematerialisation), holding and transfer of securities.
- Some rules on financial intermediation and on public companies.
- Regulation on the primary market and a secondary market.
- The exchange and OTC (over-the-counter) markets.
- Public offers and private placements of securities.
- It is incumbent on the Bank of Mozambique to regulate and supervise the capital markets.

As mentioned above, the Securities Code is much shorter than similar codes in other jurisdictions, which in itself is not necessarily negative. Given the preliminary stage of Mozambican capital markets, regulation, even if conservative, should not be such a burden which, in practice, would hinder market operators to engage in capital markets transactions.

In any case, there is room for improvement, which could help to bring some dynamic to the market, notably:

- There could be a conflict of laws rule which would allow the parties' (i.e. issuer and investor) rights and obligations under debt securities to be governed under a foreign law – this could open the door for English or other internationally more common laws to be used and attract direct foreign investment in such securities.
- An actual and consistent regime on financial intermediation could be included; this could be principle-based and include areas such as conflicts of interest, compliance, risk management, etc., which could help improve confidence by national and foreign investors in local financial intermediaries.
- The range of situations where administrative authorisation is required to undertake an issuance in the primary market could be reduced.
- Regulation of transactions of listed securities could be loosened, notably by allowing transactions of such securities OTC.
- Besides the subscription of public debt, some additional exceptions for the public offerings regime could be included, such as a wholesale exemption, a qualified investor exemption or a number-based exemption (which in any case should be quite lower than under the EU Prospectus Directive) – this could be useful to attract investment in the capital markets without a significant risk for investors, as we are not discussing retail placements of securities under such exemptions.

Commercial Code

Besides the Securities Code (which governs securities in general), the issuance of corporate bonds is further regulated in the Commercial Code.

There is some detailed (too detailed) regulation on convertible bonds and some rules for bonds in general. We see some relevant room for improvement, without which probably the market will not

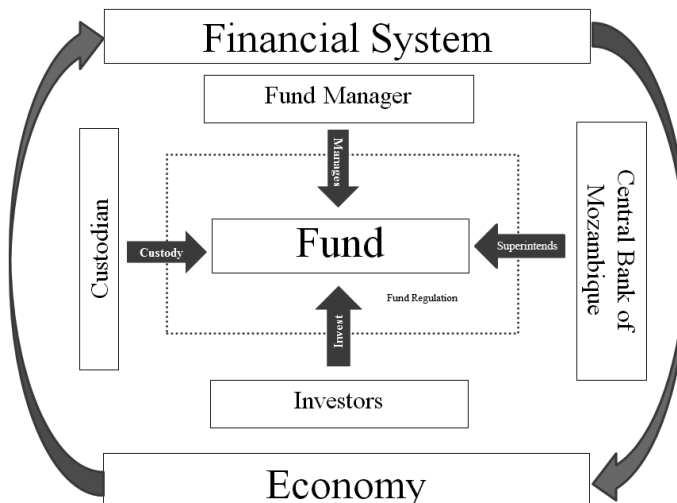
expand. Documentation-wise, the regime could be more flexible (instead of demanding a deed, a corporate resolution should suffice) and the rules on owning bonds more flexible. Very importantly, there is currently a limitation which precludes issuance in excess of the share capital amount. This seems to have been inspired by the old Portuguese legal regime on bonds, and experience shows that the Portuguese corporate bond market grew very significantly when such type of restriction was loosened (it is foreseen that it will be further loosened). On the other hand, and under similar considerations, the law does not allow corporate bonds to be issued by newly constituted corporates; it generally requires them to have been incorporated for over two years (otherwise they will not be able to meet the requirement to have accounts for at least two financial years).

Finally, we also think it to be too restrictive for the bondholders' representative to be an individual, which precludes professional entities from providing agency & trust services (and which contribute to investors' confidence) from being engaged.

Investment funds and venture capital funds

In this respect, the regime applicable to investment funds and to venture capital funds evidences a number of similarities, the main difference being the type of assets they invest in, as detailed below.

A fund is an estate of assets and liabilities managed by a management company, under the terms of a fund regulation and with the benefit of a custodian. The Central Bank of Mozambique is in charge of authorising the constitution of a fund.



Aside from the foregoing, we would note the following specifics of the legal regime of investment funds, contained in the Investment Funds Regulation:

- Investment funds can be either funds investing in securities or real estate investment funds.
- They can be of an open-end and closed-end type.
- They shall be managed by fund management companies or (closed-end only) by retail or investment banks.
- General limitations imposed on fund management companies include borrowing, extending credit and providing guarantees and, generally, there is the underlying intention of preventing conflicts of interest.
- Custodians may be retail or investment banks, who may not act as fund managers.

According to articles 4 and 27 of the Investment Funds Regulation, the Central Bank of Mozambique shall produce the regulation to implement this regime, namely in respect of:

- The incorporation of the management companies.
- The composition of the investment funds' portfolio.
- The establishment of thresholds regarding investment in securities issued by a single entity.

- The establishment of thresholds regarding investment in other investment funds.
- Calculation of the net asset value (NAV) per unit.
- Risk hedging.

Regarding the Venture Capital Funds Regulation, we would highlight the following:

- Venture capital is defined as the acquisition of shares in companies with high growth potential, with the purpose of increasing profitability and the subsequent sale of such shares, hence recovering the capital invested and obtaining a profit margin.
- The management of venture capital funds can be undertaken by venture capital companies, retail banks and investment banks, or other financial institutions authorised by the Ministry of Finance, upon consultation of the President of the Central Bank of Mozambique.
- The minimum capital for its incorporation is 5mn meticaís (roughly, \$160,000).

Article 16 established that the Central Bank of Mozambique should produce the necessary regulation to implement this regime, namely in respect of:

- Rules concerning the composition of the funds.
- Limits on the acquisition by the management company of fund units.
- Calculation of the NAV per unit.
- Additional information to be requested in respect of the funds' accounts.

At the time of writing, the regulations by the Central Bank of Mozambique are yet to be published, and thus the establishment of Mozambican-based funds is legally inoperative. This does not mean that investors cannot invest in Mozambique through undertakings for collective investment; they can and do – but by using forms of investment funds established abroad and operated under foreign legislation.

Indeed, there is certainly room to improve the current legislation. For instance, a more extensive list of duties of the management companies and organisational requirements could help investors' confidence at a time when there is still no local investment funds market. Also, and as experience has shown in a number of jurisdictions, a friendly tax environment may be key. In an economy where real estate needs to be developed at various levels, exempting or lowering taxation on property, transfer and other taxes would certainly be much welcomed.

Particularly regarding venture capital funds, it would be useful if it is clarified that distributions can be made to investors via capital reductions until the initial equity has been fully repaid, which entails an obvious tax advantage, counter-balancing the riskier nature of a venture capital investment. In light of the specific scope of this sort of investment, venture capital can be a very useful tool in developing an emerging economy, and thus it is perfectly grounded that legislation assists, as much as possible, investors in their ventures.

Investors tend to favour, not least for legal reasons, consolidated and consistent legal regimes, and thus the enactment of a new and consolidated set of legislation could be an efficient way forward.

Other laws

In consideration of the legal regulatory framework in Mozambique, reference could also be made to the following statutes, where local concerns can be identified, establishing rules expected to boost the market: Law nr. 15/2011, of 10 August, on Public-Private Partnerships (“PPP”), Business Concessions and Mega-Projects, its respective Regulation, approved by Decree nr. 16/2012, of 4 July (“PPP Regulation”); and Law nr. 21/2014, of 18 August (“Petroleum Law”).

The PPP Regulation establishes, *inter alia*, that PPPs, local strategic partnerships (LSPs) and concessions shall be executed through a local commercial company and that a percentage between 5% and 20% of its share capital shall be offered preferentially to Mozambicans, and listed on Mozambique's stock exchange. Along the same lines, the Petroleum Law establishes that the oil and gas companies must be listed on Mozambique's stock exchange, in terms to be set forth in the Petroleum Regulation, which has yet to be enacted.

Thus, and leveraging the natural resources industries, it can be expected that capital markets will start developing on the basis of these legal foundations.

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