The Lending and Secured Finance Review

Ninth Edition

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PREFACE

This ninth edition of *The Lending and Secured Finance Review* contains contributions from leading practitioners in 15 different countries, and I would like to thank each of the contributors for taking the time to share their expertise on the developments in the corporate lending and secured finance markets in their respective jurisdictions, and on the challenges and opportunities facing market participants. I would also like to thank our publishers without whom this review would not have been possible.

I hope that the commentary that follows will serve as a useful source for practitioners and other readers.

Azadeh Nassiri
Slaughter and May
London
June 2023

Chapter 11

PORTUGAL

Rodrigo Formigal and João Carvalho[1]

I OVERVIEW

i Lending market

In the aftermath of covid-19, initial signs of economic upturn have recently been countered by a combination of rising inflation, tightening of monetary policy, supply chain disruption and the effects of the war in Ukraine. Despite this, Portugal's GDP increased around 7 per cent in 2022.[2] Inflation levels are expected to average 5.5 per cent in 2023, and interest rates in the domestic lending market are also likely to keep rising during the year. Given that almost every loan in Portugal is at variable interest rates, the cost of debt has significantly increased for households and corporates.

At the end of 2022, the government approved a series of measures aimed at mitigating the impact of rising interest rates on household mortgages by imposing reasonable forbearance and introducing additional tools to facilitate the repayment of loans (including the suspension of prepayment fees).

Traditional bank loans remain the single most relevant source of financing for businesses in Portugal (around 42 per cent), while the total amount of loans is averaging 80 per cent of the country's GDP.[3] Local and international banks continue to be the most active players on the lender side of the market, and a consolidation trend in the domestic banking sector remains visible. Syndicated loan agreements continue to be extensively used by lenders who want to reduce their risk exposure in the context of a loan.

However, private placements of bonds and other debt instruments has increased as an alternative source of funding, especially in cases where the subscriber is a non-resident entity – mainly because of regulatory limitations to professional credit granting by non-licensed entities in Portugal as well as applicable tax incentives when the bonds are cleared with a clearing and settlement system such as Interbolsa.[4] Green and hybrid bond placements surpassed €4 billion in 2021.

Somewhat surprisingly, non-performing loan (NPL) ratios continued to decrease in 2022 (down to an all-time low of 3 per cent in Q4 2022), while the share of stage 2 loans decreased slightly to 10.3 per cent in Q4 2022 when compared with the same period in 2021 (although signalling an increase from the previous quarter).

1 Rodrigo Formigal is a partner and João Carvalho is an associate lawyer at Abreu Advogados.
2 Source: Portuguese Institute for Statistics.
3 Source: Bank of Portugal.
4 Interbolsa – Sociedade Gestora de Sistemas de Liquidação e de Sistemas Centralizados de Valores Mobiliários, SA (Interbolsa), operator of the Portuguese settlement and central securities clearing systems.

ii Banking sector

Deleveraging and strengthening of capital and liquidity levels have been a top priority for Portuguese banks. Although returns have improved, the sector has relied centrally on commission-based models and a strong shift towards digital services has likewise been visible. Furthermore, Banco Português de Fomento, the public promotional bank, was created on 3 November 2020 with a view to promote growth and access to funding, especially for small and medium-sized enterprises (SMEs).

iii Loan documents

Financing agreements in the Portuguese law market do not typically follow Loan Market Association terms or other industry standards. However, these are commonly used as a reference in negotiating and drafting documents, especially in cross-border and syndicated loans. In traditional bilateral agreements, Portuguese banks will generally propose their standard documents, but room for negotiation may be available depending on the particulars of the transaction and borrower profile. Most bank loans provide for a floating interest rate, with EURIBOR as the market benchmark. Standard yield determinants, such as zero-based floors, and yield protection provisions, including increased costs, break and payment costs, tax gross-up and tax indemnity, have become an established market practice.

II LEGAL AND REGULATORY DEVELOPMENTS

Recent key legal developments include the following.

i Loan funds

Loan funds were introduced in Portugal by Decree-Law 144/2019, of 23 September. Loan funds are expressly authorised to lend directly to corporate entities (especially SMEs), to participate in loan syndicates or to acquire loans originated by banks (whether performing or non-performing).

ii Participative loans

The framework applicable to participative loans was established in 2021, by Law 99-A/2021, of 12 January. Participative loans are a hybrid means of financing, whereby the participative loan is remunerated and repaid partially on the basis of the borrower's results (similar to quasi-equity). In addition, any outstanding loan amounts may be converted into equity upon default or a similar event. The framework may contribute to diversify the available sources of funding, notably to SMEs.

iii Directive on Credit Servicers and Credit Purchasers

The Directive on Credit Servicers and Credit Purchasers,[5] which was finally approved in 2021, establishes a harmonised framework for NPLs originating in EU banks through the creation of a level playing-field secondary market. Once transposed (which shall occur by the end of 2023), EU credit servicers will be required to obtain an authorisation in their

5 Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU.

home Member State but will be able to passport it into other jurisdictions. As for EU credit purchasers, these will have to appoint a credit institution or authorised servicer to perform servicing activities in respect of consumers.

iv Amendments to the Portuguese banking framework

In 2022, Portugal transposed into national law the EU Directives that make up the 'Banking Package', especially CRD V[6] and BRRD II.[7] As a result, the Portuguese banking framework was amended in line with these, notably regarding:

a licensing requirements for (mixed) financial holding companies;
b intermediate EU parent undertaking requirements;
c internal governance requirements (especially regarding gender-neutral remuneration policies);
d capital requirements (particularly, leverage ratio, net stable funding ratio and Pillar 2 capital add-ons); and
e the resolution framework (especially regarding the contractual recognition of bail-in and minimum requirement for own funds and liabilities, noting that no minimum denomination for the sale of eligible liabilities has been set).

v The forthcoming Banking Activity Code

In 2021, the Bank of Portugal approved a final draft of the new Portuguese Banking Activity Code, which, if passed by Parliament, will replace the current legal framework governing banking activities and the provision of financial services in Portugal. The draft aims to consolidate, in a single piece of legislation, the framework for banking activities in Portugal. The new Code is expected to be approved in 2023.

III TAX CONSIDERATIONS

i Stamp tax

Generally, financial transactions are subject to stamp tax in Portugal.[8] Notably, these include credit granting, granting of security or guarantees, and interest and fee payments.

Stamp tax will be due if the loan, security or guarantee documents are executed (or otherwise presented, notably for registration or enforcement purposes) in Portugal, or whenever the borrower, security provider or guarantor is an onshore entity.[9]

Stamp tax is levied over the principal amount of the loan or the value of the secured obligations. For tax reasons, the latter is typically limited to an agreed maximum secured

6 Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures.

7 Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC.

8 Stamp Tax Code, enacted by Law 150/99, of 11 September, Article 1(1) and Table II, Paragraphs 10 and 17.

9 ibid, Article 4(1) and (2). A borrower shall be deemed resident in Portugal if it has its registered office in Portuguese territory or is acting through a subsidiary, branch or other permanent establishment located in Portugal.

amount, often based on the value of the security assets or the guarantor's total exposure. Stamp tax rates vary on the basis of the term of the loan and on the security period, as shown below.[10]

Stamp tax rates

Maturity of loans and duration of guarantees	Stamp tax rate
Less than 12 months	0.04 per cent, per month or fraction
Equal to or above one year and up to five years	0.5 per cent
Equal to or over five years (or without a specific deadline)	0.6 per cent
Current accounts or overdrafts or any other form where the utilisation term is not determined or cannot be determined	0.04 per cent on the monthly average of the debtor's total daily balances, during the month, divided by 30

Regardless of who the taxable entity is, the economic burden shall fall on the obligor.[11]

However, no stamp tax will be levied on the granting of security or guarantees if they are materially accessory to, and granted simultaneously with, any obligations that were subject to stamp tax in Portugal.

Interest, commissions and fees charged by financial institutions in connection with loan agreements are also subject to stamp tax at a rate of 4 per cent.

ii Withholding taxes

Generally, interest due by a Portuguese resident borrower to a non-resident lender[12] is subject to withholding tax in Portugal.[13]

The withholding tax rate for outbound interest is 25 per cent, and payment is due on the maturity date or payment date, whichever occurs first.[14] The rate is increased to 35 per cent if the lender is resident in a blacklisted jurisdiction.[15] Reduced rates may be available under double tax treaties (DTTs), which tend to vary between 10 per cent (e.g., the UK)[16] and 15 per cent, but may be as low as 5 per cent.

Portuguese law provides for an exemption on interest payments made by Portuguese corporate borrowers to financial institutions resident in Portugal, but not to foreign financial institutions. The Court of Justice of the EU has found this provision to be in breach of EU law (non-discrimination) in relation to financial institutions resident in other Member States.[17] Although Portuguese law has not yet been amended accordingly, this is anticipated.

10 ibid, Paragraphs 10 and 17 of Table II.
11 ibid, Article 3(1), (3), (e) and (f).
12 Unless the lender has a branch or permanent establishment in Portugal to which the interest payment is allocated for Portuguese corporate tax purposes.
13 Corporate Income Tax, enacted by Law 2/2014, of 16 January (as amended), Article 94 et seq. (CIT Code).
14 ibid, Article 94(4) and (6).
15 The list of countries, territories and regions with favourable tax systems is included in Decree 150/2004, of 13 February, as amended. The UK overseas territories and Crown dependencies are included in the Portuguese list of tax havens.
16 Income Tax Convention, United Kingdom–Portugal, signed 27 March 1968 (entered into 17 January 1969), Article 11(2) (provided all the conditions for the application of the DTT are met and subject to the MLI principal purpose test).
17 See *Brisal and KBC Finance Ireland v. Fazenda Pública* (C-18/15) ECLI:EU:C:2016:549 (13 July 2016), [55].

Conversely, interest paid by Portuguese issuers to non-resident investors on bonds or securitisation transactions are exempt from income tax (subject to certain conditions).[18]

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Alongside the provision of guarantees,[19] the creation of security interests in favour of lenders remains the most common form of credit support in Portuguese law loan agreements. Security interests created by operation of law and in connection with loans to consumers are beyond the scope of this section.

General principles

There are essentially three main principles that govern the taking and enforcement of security interests under Portuguese law, namely:

a specificity: a security interest (particularly *in rem* security) may only be created over assets that are existing and specifically identified;

b publicity: creation of security interests must fulfil certain publicity requirements to be effective against the debtor or other creditors; and

c judicial enforcement: a general requirement to have a court decision and a court-monitored procedure for realisation of the collateral.

Under Portuguese law, floating security interests are virtually inadmissible. The principle of specificity prevents security from being validly taken over a class of assets of the debtor with collateral varying from time to time until crystallisation (upon default or similar event). For similar reasons, a universal business charge-like security is not recognised in Portugal. Universal mortgages are explicitly prohibited and deemed void.[20]

In principle, security interests cannot extend to future-acquired assets of the borrower. This is certainly true for mortgages and pledges of real assets, which require that the asset exists and is owned by the security provider at the time of granting the security. At most, the security provider may undertake to create the security interest whenever it acquires the asset, by way of a promissory security agreement (subject to the remedy of specific performance and typically accompanied by an irrevocable power of attorney in favour of the secured parties), but the security will not come into effect automatically upon acquisition.

Differently, security to cover future-incurred obligations is generally recognised in Portuguese law, particularly in the case of mortgages and pledges. For secured creditors, this means that the relevant security will be deemed created at the time of registry or execution, hence before the date on which the debtor incurs new debt – and thereby ranking above security created in the meantime. However, future indebtedness shall pass the determinability test for the security to be valid, which in practise requires that the parties provide sufficient

18 Decree Law 193/2005, of 7 November (as amended).

19 In Portuguese law, the term guarantees refers interchangeably to undertakings by third parties to comply with the payment or performance of another person's obligations, in the event of default (these are commonly referred to as personal guarantees); and the granting of certain assets as collateral to an obligation, either by the debtor itself or by a third party. In this chapter, the term guarantee is reserved to the first form of credit support, while security interests is instead used to describe the latter.

20 Decree-Law 47344/66, of 25 November (as amended), Article 716(1) (Civil Code).

detail to such indebtedness (such as the source, nature, time frame and maximum amount). Generic mortgages (i.e., mortgages that secure any future claims from the mortgagee) have been consistently upheld by Portuguese courts, provided the nature of the relationship wherefrom the debts may arise and the maximum amount are set forth in the mortgage deed.[21]

Once created, security interests remain valid and effective throughout their lifetime (if a security period is agreed) and shall automatically terminate only when their deadline (if any) lapses or once the secured obligations are discharged in full. Therefore, no further action is required on behalf of the secured parties or the obligors.

The provider of *in rem* security may not be prevented from transferring or further encumbering the security asset, with any clauses to that effect being null. However, the loan agreement may entitle the lenders to accelerate the loan upon the sale or encumbrance of the pledged or mortgaged assets.[22]

The concept of security trusts is not recognised under Portuguese law,[23] with a limited exception applying to the Madeira Free Trade Zone. In fact, Portuguese law does not provide for a distinction between beneficial and legal ownership. What is more, *in rem* rights are subject to a *numerus clausus* principle, meaning that trust-like arrangements cannot be validly created under the principle of freedom of contract. As such, assets held by a security trust (the secured covenant to pay) are not immune from personal creditors of the trustee.

Instead, the appointment of a security agent is standard practice in Portugal, especially in syndicated deals. Additionally, instead of having all lenders recorded as holders of the secured obligations and corresponding security, which would entail the need to execute transfer documents, issue confirmation documents or execute a new notarial deed each time the lenders assign, buy or sell part of the loans, the commonly adopted lender-friendly alternative has been to appoint the security agent as the sole registered beneficiary of the security, a practice made possible by taking advantage of the joint and several creditor concept and having a parallel debt covenant in the loan documentation.

Under Portuguese law, there is no specific limitation on the value of the security assets in relation to the amount of the borrower's obligations Over-collateralisation may nevertheless impact the amount of stamp tax to be paid.[24]

Subject to the provisions of the EU Rome I Regulation, parties to the finance documents are free to choose a governing law other than Portuguese law.[25] However, as regards the security agreement, *in rem* security over assets located in Portugal (such as mortgages or

21 See, for instance, the Supreme Court Decision of 7 November 2011 (Case No. 317/04.5TBVIS-C.C1.S1), the Lisbon Court of Appeal Decision of 7 of February 2019 (Case No. 2984/15.5T8FNC-A.L1-8) and the recent Oporto Court of Appeal Decision of 21 June 2021 (Case No. 24516/18.3T8PRT-A.P1), all accessible at www.dgsi.pt.

22 Civil Code, Article 695. Albeit the sale or encumbrance of the asset, the security interests created to the benefit of the lender will remain in place.

23 Portugal has not signed the Hague Conference on Private International Law's Convention on the Law Applicable to Trusts and on their Recognition 1985.

24 See above, 'Stamp tax'.

25 Regulation (EC) No. 593/2008, of 17 June, on the law applicable to contractual obligations, Article 3(1) (Rome I Regulation).

pledges over real assets) shall be governed by the laws of Portugal, pursuant to the doctrine of *lex loci rei sitae*.[26] In addition, Portuguese courts shall have exclusive jurisdiction for the enforcement of mortgages over real property located in Portugal.[27]

Regarding enforcement, the general rule in Portuguese law is that out-of-court enforcement of security is not permitted. First, enforcement shall in principle be effected within a court proceeding, notably through the judicial sale of the relevant assets. To initiate enforcement proceedings, creditors will need to hold an enforcement title, which, under Portuguese procedural law, may either be the finance documents if executed in the form of a public deed or an authenticated document, or a judicial award ordering the borrow to pay.[28] Therefore, lenders invariably require finance documents to be authenticated, typically with a Portuguese notary. Second, secured creditors are not generally allowed to appropriate the collateral, with any provisions conferring such powers being null. However, Portuguese law provides for certain exceptions to both these rules, notably in the case of pledges (but not mortgages).[29] When permitted, extrajudicial enforcement must be conducted in good faith and according to reasonable commercial terms.

On insolvency, all enforcement proceedings are suspended, powers of attorney granted to enforce security terminated, and lenders must launch their claims within the insolvency proceedings.

Mortgages

A mortgage is a security interest that entitles the beneficiary to be paid with preference in relation to other unsecured creditors from the proceeds of the sale of the mortgaged asset, which may include:

a immovable property;[30]

b *in rem* rights relating to immovable property;[31]

c movable assets subject to registration;[32] and

d public concessions rights.

A mortgage may secure the principal obligation as well as ancillary rights, such as interest up to three years, fees, penalties and enforcement expenses, up to the maximum secured amount, provided ancillary rights are mentioned in the registration.

Furthermore, formality requirements vary on the basis of the type of mortgaged asset. For real property and rights related thereto, mortgage deeds must be executed by means of a public deed (executed by a Portuguese notary) or an authenticated document.[33] In any event,

26 Civil Code, Article 46(1).

27 Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, Article 24(1) (Brussels I (recast) Regulation).

28 Civil Code, Article 703(1).

29 See below 'Pledges'.

30 e.g., land, buildings or building units.

31 Such as surface or usufruct rights over real property.

32 Namely automobiles, ships and aeroplanes (being possible to create an independent security interest over its engines).

33 Authentication of private documents consists of the certification of the identity, capacity and powers of the signatories to enter into the mortgage deed, performed by a lawyer or a notary.

a mortgage is only created when definitively registered with the competent asset registry office. In commercial real estate lending, the mortgage is sometimes accompanied by a consignment of income arising from the real estate asset, which is likewise subject to registration.

Finally, enforcement of mortgages must take place through a judicial procedure, meaning that out-of-court foreclosures are inadmissible under Portuguese law.

Pledges

Pledges confer similar rights to those of mortgages but are created over non-mortgageable assets, which may include, among other things:

a tangible movable property;[34]
b shares;
c bank accounts;
d financial instruments;
e receivables and contractual positions; and
f intellectual property rights.

Pledges are most commonly granted over shares of companies, cash deposits in bank accounts, debt and investment securities, and receivables, given their higher marketability. Besides a general pledge, several subtypes of pledges exist under Portuguese law, each subject to specific frameworks.

Pledge over movable real property (general framework)

As a general rule, the creation of pledges over tangible assets is not subject to any formal requirements, although the means by which the pledge agreement is executed impact the enforcement procedure.[35] To perfect the pledge, dispossession of the asset must occur.[36] Regarding enforcement, the parties may agree on the creditor's right to sell the asset out of court, subject to the bona fide requirements highlighted above. Under the general regime, appropriation is inadmissible, but the asset may be awarded to the creditor through a judicial procedure.[37]

Pledge of receivables

Pledges of rights are expressly recognised in Portuguese law, with formality requirements varying based on the type of receivable.[38] In particular, a pledge of mortgage receivables must be executed by way of a public deed or an authenticated document. In any event, the debtor of the receivables must be notified of, or acknowledge, the pledge for it to be effective against the debtor.

Should the pledged receivables fall due before the secured obligation is fully discharged, the pledgee must claim the receivables, but – unless otherwise agreed – payments must be made by the debtor to both the pledgor and the pledgee, which, in practice, requires opening a separate bank account.

34 Such as equipment, machinery, raw materials and inventory.
35 See above 'Enforcing security interests'.
36 Civil Code, Article 669(1).
37 ibid, Article 675.
38 ibid, Article 578(2) *ex vi* Article 681(1).

Although not expressly foreseen, there is widespread acceptance for the admissibility of pledges of future receivables, especially among Portuguese legal scholars.[39] Future receivables may refer, inter alia, to agreements that are expected to be executed in the future, future instalments (e.g., rent or interest) or future dividends.

Nevertheless, pledged future receivables must be determinable, pursuant to general contract law requirements.[40] In practice, this means that the pledge agreement shall provide sufficient detail regarding the future receivables. Practical examples include foreseeing their source (type of agreement) or the activity from which they may derive, the counterparty's identity, a maximum secured amount and a time limit. A combination of more than one of the criteria is advisable, but the validity should be assessed on a case-by-case basis.

Pledges of future receivables will only be effective upon the creation or acquisition of the receivables by the pledgor, but notices may be served in advance with advantages for priority purposes.[41]

Pledge of bank accounts

In turn, pledges over cash deposits in banks accounts are an established market practice in Portuguese bank loan transactions, despite the absence of a specific provision. This type of pledge has been explicitly upheld in Portuguese case law,[42] and shall go undisputed when it qualifies as a financial pledge.[43] Arguably, the asset pledged is not the cash deposited itself, but rather the right to receive an amount equal to the one registered in the account against the bank.

Typically, the pledge is accompanied by the pledgor's undertaking not to withdraw or transfer any amounts deposited or, at least, to maintain a minimum standing amount. When the secured lender is the account bank, the pledgor usually authorises the bank to refuse any transfer orders out of the account, and to debit the account in the event of default of the borrower, by way of set-off. Otherwise, the account bank must be notified and acknowledge the pledge, and undertake to deliver the amounts to the lenders upon default.

Pledge of shares

Shares are among the most common collateral provided in corporate lending in Portugal, particularly in the context of acquisition finance.

Formality and perfection requirements vary based on the type of shares pledged, namely shares in quota private limited companies or shares in public limited companies.

39 Their validity is often supported on the basis of the possibility to assign future receivables and of attachments (i.e., *penhora*) over future receivables; and certain provisions expressly foreseeing pledges of certain future receivables in the context of insolvency and over copyright of future works.

40 Civil Code, Article 280.

41 Naturally, prior notification is only possible where the future debtor is identified from the outset; otherwise a notice following the creation of the receivables will be required for the pledge to be effective against the pledgor's debtor.

42 See, for instance, the Supreme Court Decisions of 7 June 2006 (Case No. 05A1774) and of 7 May 2009 (Case No. 3116/06TVLSB.S1); and the Lisbon Court of Appeal Decision of 14 June 2007 (Case No. 2815/2007-8), all accessible at www.dgsi.pt.

43 i.e., subject to Decree-Law No. 105/2004 of 8 May (which implements the financial collateral directive).

Quotas must be pledged in writing,[44] and the pledge registered with the commercial registry office.[45] By-law restrictions on the transfer and encumbrance of shares may apply, notably consent requirements from the shareholders' meeting.[46] Differently, shares (in public limited companies) are pledged as follows:

a shares represented by certificates: by registering the pledge in the respective certificates, and in the company's share registry book;[47] and

b book-entry registered shares: by recording the pledge in the relevant account.[48]

Shares in public limited companies (but not quotas) may be, and often are, pledged under the framework of financial pledges.

Shareholder rights typically remain held and exercisable by the pledgor until an event of default has occurred.[49]

Pledge of businesses

Under a pledge of business, security is granted over the pool of assets (including movable assets, receivables, contracts, etc.) that constitute, from time to time, a certain business as a going concern.

Although not specifically recognised in Portuguese law, pledges over businesses have come to be widely accepted in financial practice, backed by scholars' commentary as well as established case law.[50] Practically, this type of pledge resembles a common-law floating charge, with the pledge crystallising only on enforcement, but certain issues regarding specificity may nonetheless be raised.[51]

As regards perfection requirements, delivery (if required)[52] may be effected in a symbolic manner under the commercial pledge framework or discharged entirely when the pledgee is a bank.

44 Decree Law 262/86, of 2 September (as amended), Articles 23(3) and 228(1) (Companies Code).

45 ibid, Article 242-A; Decree Law 403/86, of 3 December (as amended), Article 3 (Commercial Registry Code).

46 Companies Code, Articles 23(4), 228(2), and 246(1), (b).

47 Decree Law 486/99, of 13 November (as amended), Article 102(1) (Securities Code).

48 ibid, Article 81(1).

49 ibid, Article 81(4); Companies Code, Article 23(4).

50 See, for instance, the Supreme Court Decisions of 6 May 1993 (Case No. 043114) and of 29 October 2019 (Case No. 2589/15.0T8STS-A.P1.S1); and the Coimbra Court of Appeal Decision of 20 June 2017 (Case No. 6100/16.8T8CBR-C.C1), all accessible at www.dgsi.pt.

51 Briefly, arguments in favour of the validity include: the legal treatment of a business as a single asset, subject to a proprietary right; the possibility to transfer or lease a business as a going concern; the provision for a seizure and attachment of a business; and the express possibility of pledging an individual limited liability establishment.

52 Given that the business is not a tangible asset, it is arguable that delivery is not required, as in pledged rights.

Commercial pledge

Pledges created to secure commercial obligations constitute commercial pledges.[53] In general, commercial pledges must be agreed in writing and delivery of the pledged asset may be effected in a symbolical manner (i.e., without actual physical possession by the pledgee).[54]

The pledgee may enforce the collateral out of court by means of a private sale, either directly or through a broker. The pledgee may also appropriate the asset upon an event of default, provided that the pledgor is a merchant; the signatures of the parties are made in the presence of a duly authorised certifying entity (notably a notary, lawyer or solicitor); and the right of appropriation is specifically foreseen along with the evaluation criteria.[55]

Financial pledge

Financial pledges were introduced in Portugal following the transposition of the Directive on Financial Collateral Arrangements,[56] and are widely used in bank loans. Financial instruments, securities and monies (including bank accounts and receivables) may be pledged to secure payment obligations under said regime. Financial pledges require a written agreement and handing over the assets to the pledgee.[57] Importantly, the financial pledgee may be entitled to:

a sell the pledged assets before maturity;

b enforce the asset extrajudicially;[58]

c appropriate the asset; and

d perform a close-out netting.[59]

Finally, financial pledges are subject to a more creditor-friendly insolvency regime; clawback provisions (under certain conditions) are set aside, refusal of performance is prohibited and the close-out netting mechanism remains applicable.[60]

Assignment of rights by way of security

Another common security mechanism in the Portuguese law market is the assignment of receivables by way of security. Unlike a pledge of receivables, in an assignment the borrower transfers effective ownership over the receivables to the secured creditor, with the secured creditor becoming the fiduciary holder of the assigned credit. The creation of this type of security is, therefore, subject to the general framework applicable to assignment agreements.[61]

53 Charter of 28 June 1888 (as amended), Article 397 et seq. (Commercial Code); and Decree-Law 75/2017, of 26 June.

54 Decree-Law 29:833, of 17 August 1939, Article 1(1); Decree-Law 32:833, of 22 May 1942, single Article.

55 Decree-Law 75/2017, of 26 June, Article 2.

56 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, transposed by Decree-Law 105/2004, of 8 May.

57 Decree-Law 105/2004, of 8 May, Articles 6 and 7.

58 By way of sale, set-off or application of the collateral.

59 Essentially, by accelerating the obligation to return the pledged asset (its value) and set-off against the secured obligation.

60 Decree-Law 105/2004, of 8 May, Article 17 et seq.; Decree-Law 53/2004, of 18 March, Article 16(3) (Insolvency Code).

61 See below 'Assignment of lender's receivables'.

Assignment by way of security of future receivables is generally accepted and quite common. Again, future receivables shall be determinable, which means that some sort of criteria must be set forth in the assignment agreement.[62]

Typically, in an event of default, the assignee may step in and sell the receivables or claim them according to their maturity. If and when the assignor is fully released from its obligations, the assignee shall transfer the receivables back to the assignor.

ii Guarantees and other forms of credit support

In Portuguese law transactions, guarantees are commonly provided on top of the security package to provide credit support for the debtor's financial obligations.[63] In the context of corporate lending, guarantors usually comprise one or more of the borrower's parent company (downstream guarantee), subsidiaries (upstream guarantee) and other associated entities (cross-stream guarantee). Specific types of guarantees include bonds, autonomous guarantees and comfort letters. Guarantee terms vary significantly, and the following issues are usually key to lenders:

a autonomy: whether or not the guarantor may rely on any defences that the debtor may raise against its creditor, based on the underlying finance documents, with autonomous guarantees having very limited defences available;[64]

b pursuance of remedies: whether or not the creditor must first pursue all available remedies against the debtor; and

c on first demand: whether or not the creditor must provide justification for demanding performance from the issuer.

Additional forms of credit support are typically included in the finance documents, and the following are market standard:

a negative pledges;

b restrictions on disposals;

c financial covenants;

d *pari passu* clauses;

e changes of control;

f restrictions on substantial changes of business and on substantial acquisitions; and

g restrictions on future indebtedness.

iii Priorities and subordination

Security interests essentially grant the secured lender the right to be paid with preference from the sale or realisation of the secured asset, ahead of unsecured creditors of the debtor. This is particularly important in the case of the debtor's insolvency, where the latter's assets will likely be insufficient to cover its obligations.

As a rule, priority between secured creditors is established according to a first-in-time principle, meaning that the first perfected security will trump security interests created or perfected afterwards.

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62 See above 'Pledge of rights', regarding the pledges of future rights.

63 For a note on Portuguese law terminology see footnote 19.

64 For case law on defenscs in autonomous guarantees, see for instance the Supreme Court Decision of 5 July 2010 (219/06.06TVPRT.P1.S1), accessible at www.dgsi.pt. These include mainly fraudulent or abuse of right exemptions, where there is manifest and clear evidence.

Some adverse claimants enjoy, by operation of law, security interests that rank higher than voluntary mortgages or pledges, regardless of their order in time.[65] The 'legal preferential' creditors – notably, tax authorities, social security, employees – may, in certain cases, be paid ahead of a secured lender upon enforcement. On insolvency, certain creditors may also rank higher in the insolvency payment waterfall.

In Portugal, subordination is usually implemented by means of contractual subordination. Sometimes, intra-group loans and shareholder loans are permitted to subsist or be executed only if subordinated to the senior loan. Contractual subordination is recognised on insolvency, with subordinated creditors ranking lower on the insolvency ladder. Other claims are subordinated by operation of law (notably, shareholder loans).

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Limitations on validity and enforceability of guarantees and security

The following topics constitute seminal issues regarding the validity and enforceability of guarantees and security and should be dealt with in the context of each transaction.

Corporate benefit

Entities in a group relation with, or otherwise related to, the borrower frequently provide guarantees or grant security to the borrower's obligations. The validity of the guarantee or security shall be assessed in light of the legal provisions that govern the guarantor's capacity and limitations thereto.

Concretely, Portuguese company law deems the provision of a guarantee or the grant of a security interest to secure debts of other persons to be contrary to the company's (for profit) purpose and interests, unless there is a justifiable corporate benefit of the guarantor in providing said guarantee or security; or the entities are in a control or group relation[66] with one another.[67]

Pursuant to the second exception, the guarantee or security will be deemed validly granted if a control or group relationship exists between the guarantor and the debtor, regardless of any considerations as to the former's corporate benefit. There is, however, some legal debate as to whether the provision applies only to downstream guarantees or extends to upstream and cross-stream guarantees.[68]

The corporate benefit exception requires a case-by-case approach. In practice, a shareholders' resolution or board resolution setting out, in detail, the guarantor's corporate benefit in the transaction will mitigate the risk of unenforceability. As such, it is standard for these resolutions to be required by secured creditors as a condition precedent.

65 Civil Code, Articles 751 and 759(2).

66 As defined in the Companies Code, Article 488 et seq.

67 ibid, Article 6(3).

68 The issue remains unsettled in Portuguese case law. In favour of the limitation, see the Coimbra Court of Appeal Decision of 07 September 2020 (Case No. 142/19.9T8FND-B.C1). Against it, see the Evora Court of Appeal Decision of 09 March 2017 (Case No. 437/14.8TBVRS.E1), both accessible at www.dgsi.pt.

Financial assistance

Portuguese public limited companies may not grant loans, advance funds, or provide guarantees or security to a third party with a view to the acquisition or subscription of the company's shares.[69] The prohibition is further extended to the acquisition of shares of a Portuguese company in a group or controlling relationship with the lender or guarantor, namely its holding company.[70]

Essentially, these restrictions aim to protect the interests of other shareholders and target creditors as part of the corporate doctrine of maintenance of capital, while also avoiding market manipulation (through the creation of a false market).

Any acts or agreements in breach of the prohibition shall be null and void, including, notably, any security granted by the target company over its assets.[71] In addition, the company's directors involved in the transaction shall be criminally liable and subject to a fine or imprisonment of up to two years.[72]

Despite the fact the prohibition is solely set forth with regard to shares in *sociedades anónimas* public limited companies, some influential scholars argue that the restrictions extend to *sociedades por quotas* private limited companies. The issue remains debatable, although there is at least one registered case in which a Portuguese court rejected the extended interpretation.[73]

Practical expedients that have been implemented include:

a splitting the loan into different tranches so as to segregate certain amounts from the acquisition purpose (e.g., a second tranche for working capital);

b securing the funding of, or financing previously existing debt; for example, the reimbursement of shareholder loans by the target company; and

c merging the target with the buyer following the leveraged acquisition.

The particulars of each transaction should be carefully analysed, as the wording of the provision is wide enough to capture certain indirect forms of financial assistance. Arguably, a 'commercial substance and reality'-like test is likely to apply in the event of litigation,[74] which may pose unenforceability risks to lenders.

69 Companies Code, Article 322, which transposed Directive 77/91/EEC of 13 December 1976 (no longer in force), Article 23 (Second Company Law Directive).

70 ibid, Article 325-A.

71 For instance, mortgages over the target's real estate assets, pledges of the target's receivables or over its shares in subsidiaries.

72 Companies Code, Article 510(1).

73 Coimbra Court of Appeal Decision of 03 March 2009 (Case No. 228/04.04TBILHV.C1) accessible at www.dgsi.pt.

74 Similar to the one applied in *Chaston v. SWP Group plc* (2003) 1 BCLC 675, where the Court of Appeal of England and Wales held that payment of transaction costs by the target amounted to unlawful financial assistance, based on a 'commercial substance and reality' test.

Clawback risks

Portuguese insolvency law provides for clawback actions to set aside certain transactions. Broadly, transactions may be challenged if they qualify as detrimental to the insolvency estate, (i.e., if they jeopardise the ability to meet creditors' claims), provided they were executed in bad faith[75] and in the two years prior to the commencement of the insolvency proceedings.[76]

In particular, guarantees and security provided by the insolvent company may be set aside by the insolvency administrator, regardless of any additional requirements, in the following scenarios:

a *in rem* security granted to secure pre-existing or novated obligations, within a six-month period prior to the commencement of insolvency proceedings;

b guarantees provided with no real interest or advantage to the guarantor within the above-mentioned period; and

c *in rem* security granted to secure new debt within a period of 60 days.[77]

Still, financial collateral agreements, including financial pledges, are generally exempt from these clawback rules.[78]

ii Legal opinions practice

As in other jurisdictions, it is standard for lenders to require legal opinions as a condition precedent to signing or funding. Typically, the lender's legal counsel is expected to provide an opinion on the legality, validity and enforceability of the finance agreements and the security package, whereas counsel to the borrower will deliver an opinion on the capacity and non-insolvency of the debtor.

Generally, reliance on the opinion is restricted to the addressees (parties to the finance documents) and no disclosure is permitted without the opinion-giver's consent. In syndicated loans, market practice has been to deliver an opinion to the syndicate members, the bank agent and the security agent. Sometimes, reliance will be permitted to counterparties of the lenders (notably for back-to-back financing), their successors or transferees (notably for securitisation purposes).

VI LOAN TRADING

As in most jurisdictions, loan transfers are widely used in the Portuguese law market. In short, lenders often seek to transfer their (participation in) loans to:

a reduce their exposure towards a certain borrower;

b remove the assets from their balance sheet and free up capital; or

c transfer distressed or NPLs to specialist servicers.

75 The company's counterparty is considered to have acted in bad faith whenever it was aware of the insolvency or of the detrimental impact of the transaction to a near-insolvent company. It is also presumed if entities especially related to the borrower participated in, or benefited from, the transaction. See the Insolvency Code, Article 120(4) and (5).

76 Insolvency Code, Article 120(1), (2), (4) and (5).

77 Reliance on good faith or no detriment is not possible within these vulnerability periods.

78 See above 'Financial pledges'.

Aside from securitisation, loans are usually traded under Portuguese law by way of an assignment of the lender's contractual position, an assignment of just its credit rights under the finance documents or a novation of the finance documents.

Sub-participation is not standard practice in the Portuguese law market, but it is nonetheless admissible under the general freedom of contract principle.

i Assignment of the lender's contractual position

An assignment of the contractual position involves the global transfer of all rights and obligations from the lender, under the finance documents, to the assignee.[79] In addition, a global transfer frees the selling bank from any obligation it may have under the finance documents, namely in the case of revolving credit facilities.

In Portuguese law, consent of the assignor's counterparty is required. Typically, syndicated bank loans set forth a free-assignability clause in favour of the lenders (sometimes with a blacklist of assignees). Regardless, the borrower must be notified of the assignment.[80]

Security interests will, by default, remain fully effective for the benefit of the transferee. However, certain perfection steps may be required, such as registration or taking possession of the collateral.

ii Assignment of the lender's receivables

Another standard form of trading loans is the assignment of a lender's credit rights, which is frequently used to place NPLs in the secondary market. The transfer is limited to the lender's rights against the debtor, which include both the right to repayment as well as any ancillary rights thereof, such as interest, fees and penalties.[81] Security interests or other form of guarantee that secure the assigned rights are likewise transferred, unless excluded in the assignment documentation.[82] Again, perfection steps may have to be taken.

In Portuguese law, debtor consent is not required for the assignment of rights to be validly and effectively executed. What is more, any provisions set forth in the finance agreements excluding assignment will not be effective against an assignee who is unaware of their existence at the time of the sale.[83] Besides, the debtor should be notified of the assignment for effectiveness and priority purposes.[84]

iii Novation

Novation of the finance documents entails the cancellation of the loans with replacement with new debt in favour of a new creditor. Novation is less common to effect loan transfers. Security and guarantees will lapse on novation, unless otherwise specifically agreed.[85] In addition, novation is likely to attract stamp tax under Portuguese law.

79 Civil Code, Article 424.
80 ibid.
81 ibid, Article 582(1).
82 ibid.
83 Transfer restrictions are not standard in Portuguese loan documentation, but may apply considering the particulars of the transaction.
84 ibid, Articles 577 and 583(1).
85 ibid, Article 861.

VII OTHER ISSUES

There are no other issues that merit mention here.

VIII OUTLOOK AND CONCLUSIONS

The Portuguese banking sector is in a stronger position, and less sensitive to shocks, than it was during the pandemic, and continued progress has been made with deleveraging and reducing problematic assets.

So far, it seems that the rise in interest rates has not had a material impact on banks' loans (i.e., the banks and government measures appear to have thus far been successful in absorbing the negative effects of the interest rate escalation), although an increase in stage 2 loans in banks' balance sheets has been noted.

If high inflation and rising interest rates scenario persists, an increase in distressed debt is likely to follow.

Portuguese banks are expected to exercise some restraint in future deals, reflected in some tightening of conditions in loan transactions (especially in the leveraged loan market), which may in turn make room for alternative lenders and other lenders acting on a cross-border basis. Debt restructuring, recovery and placement in the secondary market will be a key challenge for banks and borrowers throughout 2023 and 2024.

Financiers are yet to fully tap into the favourable market for environment, social and governance (ESG)-linked or sustainability-linked loans. However, in the real estate lending market, lenders have already begun incorporating sustainability factors into their decision-making as well as loan terms, notably in the form of valuation premiums or discounts based on a property's ESG profile. There is indeed some momentum towards ESG in the Portuguese lending market. Technological evolution remains a key factor for attracting, and retaining, customers, as well as lowering banks' costs. Over the next year, we expect landscape changes in the banking system as a whole, especially regarding regulation and supervision (with the new Portuguese Banking Activity Code) and the digital transformation and revolution that Portuguese banks are undergoing in order to compete with fintech players[86] and virtual asset service providers.

86 e.g., Klarna officially launched its activity in Portugal in November 2021.