TELLES

About Finance

GLOBAL MARKET OVERVIEW REPORT

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TELLES' review of the trending subjects with impact in the financial sector.

In this edition we address the impact of raising interest rates in the economy. Other relevant topics include the amendments to the Golden Visa regime and their impact in the asset management industry, besides courts' rulings on the financial intermediaries' duties. Finally, the resignation of the Portuguese Prime Minister and the tax impacts of the State Budget for 2024 are likewise unavoidable subjects.

Finance Outlook

Interest: how long is long enough?

These are uncertain times, not only in the world due to the armed conflicts in Ukraine and Israel and Palestine, but also in Portugal, being this uncertainty exacerbated by the current political context. As we deep into the end of the last quarter of 2023, companies setting budgets and targets for 2024 are looking to the future with concern. However, the signs from the economy are highly contradictory.

On one hand, the debt burden is a cause for concern. The yield on 10-year Portuguese government bonds was 3.59% in October, whilst in 2021, for example, it was just 0.3%. We must go back to 2014, the start of the easing of the sovereign debt crisis to find a higher rate, when it was 3,8% [1]. This upward trend in government bond yields may be found across several other jurisdictions.

The pressure on countries in the European Union as the price of debt rises, mainly because of the increase in the reference rate imposed by the ECB, has changed the pattern of public debt sustainability in recent years.

So far, the relative reduction in the debt burden has been based on maintaining the tax burden (not to mention increasing it through indirect taxes), which, combined with the easing of the price of debt, has allowed the relative weight of debt in relation to GDP to be reduced to levels below those recorded before COVID (it was 116.6% in 2019 and will be 106.1% in September 2023, according to the forecasts of the Ministry of Finance [2]). The so-called "fiscal fantasy" [3].

However, despite the recent worsening of the debt burden, even

[1] Source: Banco de Portugal (www.bportugal.pt) and Pordata (www.pordata.pt).
[2] Source: Portdata.
[3] An expression coined by the Economist in October 2023 about tax measures implemented by the Italian governement.

for companies and individuals, the Portuguese economy has proved more resilient than might have been expected. According to the Bank of Portugal's October Economic Bulletin, the national economy will grow by 2.3% in 2023.

Nevertheless, this paradigm shift in public debt sustainability is forcing governments to devote more tax revenues to debt servicing, leaving the "short straw" for investment and economic growth needs. This is why the Bank of Portugal is forecasting growth of just 1.5% in 2024 and 2.1% in 2025, exacerbated of course by persistent inflation and the risk of rising commodity prices. The point here is to know how long the price of debt can remain at current levels in a scenario of weak economic growth and poor public debt sustainability.

The latest comments from Christine Lagarde, President of the European Central Bank, imply that she will accept a reduction in the ECB's reference rate in the coming quarters if euro area inflation remains at 2% for long enough. This also means that we can expect the current reference rate to be maintained, at least for the time being. Given the current scenario of uncertainty, we can find good news here for 2024: although the cut is not expected for the time being, the signs are that we can at least expect the reference rates to remain at values close to the current ones, at least in the first half of 2024. We'll see how this affects the economy and what the 2024 general election will bring.

Hot Topics

The changes to the Golden Visas and the impact in the asset management industry

The new laws in Portugal to fight the housing crisis is already in force, affecting the Golden Visas legal framework. With the implementation of the measures of Law 56/2023, it is important to understand the real impact of these changes on the investment and housing market. Will venture capital be eligible? What about property-based business models?

Keeping the focus on the financial sector, we will only refer to the changes in the investment modalities under the Golden Visa Program.

With the entry into force of the *Mais Habitação* Program (the law aiming at fighting back the effects of the housing crisis), the possibility of obtaining a residence permit for investment activities based on (i) the transfer of capital in the amount of EUR 1,000,000.00 and (ii) real estate investments in the amount of EUR 500,000.00 or more have been eliminated.

However, within the investment modalities eligible for obtaining the residence permit, the subscription

of units in collective investment undertakings constituted under Portuguese law, other than real estate, is maintained, provided that the duration of the investments is at least 5 years and that 60% of the value of the investment is made in companies incorporated in Portugal.

The legislative choice of the *Mais Habitação* Program law to make a reference to “collective investment undertakings other than real estate” has created some uncertainty, as it has opted to use language that is not specific to the sector’s legislation (the new Asset Management Regime) and to use a negative definition. This leaves the question of which collective investment undertakings are eligible to obtain a residence permit for investment activity.

One of the questions that has arisen is whether venture capital funds are eligible and what the investment limits are for this type of fund in order to obtain the so-called “golden visa” for investors.

According to the Asset Management Regime, venture capital investment is considered to be “the acquisition of equity and debt instruments in companies with high development potential in order to benefit from their appreciation”.

Since venture capital funds are not intended to invest in real estate, and since this is expressly excluded by the legislator in the preamble to Decree-Law No. 27/2023, which publishes the Asset Management Regime, it is easy to conclude that this type of fund will therefore be eligible for the Golden Visa.

Nonetheless, this definition of venture capital does not seem to preclude target companies from having a business project with a business model based on indirect exposure to real estate, a claim also supported by the Portuguese Securities Commission in its Circular DGCI/2013/11 of 18 May 2012.

Under the terms of the *Mais Habitação* Program Law, in order for a venture capital fund to be fully eligible, in addition to the requirements related to the characteristics of the investment, it is necessary that the fund in which it invests does not include, directly or indirectly, any real estate investment, although the term “real estate investment” is not defined.

We believe that this term should be interpreted as meaning an economic activity whose underlying economic activity consists solely or substantially of exposure to real estate, and that the reference to “directly or indirectly” should be interpreted as referring only to the way real estate may be held, for example directly or through various vehicles or holdings.

Thus, activities based on the economic exploitation of real estate assets should not be excluded, if this exploitation is based on a business model that creates real value and is not the result of mere speculation on the real estate asset - thinking, for example, of hotel business models, agriculture, senior residences. These are all models with a strong real estate component, but whose valuation is not solely the result of buying and selling the asset.

Court Cases

Financial Intermediaries' duties, conflicts of interest and disclosure requirements.

The Supreme Court of Justice (STJ) recently ruled in two separate cases on the rules governing the duties of financial intermediaries when marketing financial instruments to non-professional investors.

One of the decisions (judgment of 28 September 2023, case 25924/15.7T8LSB - A.L1.S1) concerned the recognition of a claim in the course of the judicial liquidation of a bank branch.

In this case, the non-professional investor subscribed to commercial papers issued by a company belonging to the same group as the selling bank, by means of an oral order without registration in a written document. This decision is relevant for the interpretation of the legislation concerning (i) the obligations of financial intermediaries, in particular with regards to the registration and acceptance of orders, and (ii) the treatment of conflicts of interest.

As for the verbal transmission of the order, the STJ clarified that current legislation allows orders to buy financial instruments to be given orally or in writing, without considering the written form a formality whose non-compliance affects the validity of the order or its proof.

In this sense, the court held that the failure to reduce orders given orally to writing does not imply that the order itself is null and void, nor does it imply that it cannot be proved by testimonial evidence (as happened in this case). Until now there had been doubt as to whether the failure to put the order in writing (which is a duty of financial intermediaries) would affect the contractual relationship. The court ruled that the rule establishing this duty is not special in comparison to the Civil Code, and that the principle of freedom of form prevails for this type of business, even though one of the parties may be in breach of its regulatory duties in the sector.

With regard to conflicts of interest, Article 309-M of the Securities Code stipulates that financial institutions must avoid or reduce the risk of conflicts of interest and that, should a conflict arise, the financial intermediary must manage it with "transparency and fairness", always giving priority to the interests of the client.

However, the Court held that the mere fact that an intermediary belongs to the same financial group as the issuer of the bonds does not in itself constitute a conflict of interest, if the obligations of transparency and the interests of the client are respected. In our view, such a broad interpretation of the concept of conflict of interest sets a precedent that makes it difficult to identify potential conflicts of interest. When analyzed from the point of view of the benefits to the client, any product with a higher return (if it is suitable for the client from the point of view of risk) is unlikely to give rise to a conflict of interest on the part of the intermediary, which in our view renders the rule and the duties it entails meaningless.

It is also important to highlight the recent uniform case law of the STJ (Uniform Case Law Ruling 8/2022), which determined how to verify the causal link between the actions of financial intermediaries who fail to comply with their information duties and the investment decision of investors. According to this jurisprudence, to establish a causal link and thus liability on the part of financial intermediaries, it is necessary for investors to claim and prove that they would not have taken the investment decision if they had received all the information.

This case law was recently followed by the STJ in its judgment of 17 October 2023 (Case no. 675/18.4T8TVD.L1.S1), in which the investor claimed that he had only subscribed to a certain investment because he had been assured that this product was similar to a term deposit, but with a better return and without risk, with the possibility of moving at any time, even though it had a maturity of ten years. The STJ ruled that the financial intermediary's actions were unlawful because it had breached its duty of information by failing to inform the client of the subordination feature in the context of payment at maturity. However, the court also held that there was no obligation to compensate the investor in the absence of a causal link (determined in accordance with the above-mentioned uniform case law). This is because the investor did not prove to the court that he would not have subscribed to the investment if he had received full information from the bank.

Therefore, financial instrument trading companies should take these recent case law positions into account and adapt their investment subscription forms accordingly. It will not only be important for investors to receive all the legally required information in writing, but also to state that they base their decision on the information received.

Legal Updates

European Sustainability Reporting Standards

On 31 July 2008, the European Commission adopted a Delegated Regulation establishing the first set of European Sustainability Reporting Standards and complementing the Corporate Sustainability Reporting Directive (CSRD). The adopted standards are mandatory and specify the information to be disclosed by the companies covered - namely large companies (i.e. those exceeding at least two of the following three thresholds: balance sheet total of EUR 20,000,000, net turnover of EUR 40,000,000 and average number of employees of 250)

and small and medium-sized companies with securities listed on a regulated market in the EU, as well as the parent companies of large groups - in fulfilling their obligation to communicate their position and performance with regard to environmental, social and governance (ESG) sustainability, as well as the material risks and opportunities that have arisen in this area.

The Delegated Regulation will apply as of January 1, 2024 to companies that were already subject to non-financial disclosure requirements under Directive 2014/95/EU, which means that large companies as defined above, which are public interest entities with an average number of employees of more than 500, on the one hand, and public interest entities that are parent companies of a large group with an average number of employees of more than 500, on the other hand, will have to integrate the standards adopted here in their annual reports for the financial year 2024. For the other companies covered by the CSRD, which extended the scope of the previous Directive, the implementation of sustainability reporting standards will follow a phased approach and it is expected that by June 2024 the European Commission will have adopted specific sectoral standards (the CSRD has already identified the agriculture, forestry and fishing, transport and storage and real estate sectors as being associated with high risks), proportionate standards for small and medium-sized listed companies and standards for companies from third countries.

It is therefore essential that companies start working now to ensure that they have the quality of information needed to prepare the sustainability report in a way that is fully compliant with the CISE Directive and the Sustainability Reporting Standards. In this context, they may even find it necessary to operationalize data collection, monitoring and reporting processes, or even to select an external entity to verify their financial statements.

Still in the context of the EU's sustainable finance strategy, it is worth mentioning that this month the European Parliament's Committee on Economic and Monetary Affairs published its draft report on the proposal for a Regulation on the transparency and integrity of ESG rating activities, which aims to help investors make more informed decisions by requiring ESG rating service providers in the Union to be authorized and supervised by the European Securities and Markets Authority.

Tax

State budget for 2024 and new government

After significant back and forth, the State Budget Law for 2024 was approved last November 29, coming into force on January 1, 2024.

As usual, the State Budget Law contained several tax measures, amongst which we would like to highlight:

i) the repeal of the Non-Habitual Resident (NHR) regime, and introduction of a new expat regime for “Innovation and Scientific Investigation” (allowing i.a. for 20% flat tax rate on active income and full foreign passive income exemption for certified start-ups´ staff and management), with effect as from January 1, 2024, and

ii) the possibility to, subject to certain conditions, opt for the transfer of tax cases pending before judicial courts (which are not bound to a maximum decision period) to arbitration courts formed before ´CAAD Arbitration Centre´ (generally subject to a decision period of up to 12 months).

Before that, the State Budget Proposal had been presented by the Portuguese Government to the Parliament on October 10th and risked not seeing the ´light of day´ following the Prime Minister´s (request for) resignation on November 7, after a statement being issued by the Attorney General’s Office revealing his potential involvement in a corruption case, noting that, under the terms of the Constitution of the Republic, the acceptance of the Prime Minister´s request would have meant the resignation of the government and consequent expiration of pending proposals.

However, in an unforeseen move, the President of the Republic announced that he would only accept the resignation in a deferred manner so that, among other, the Proposal could be approved.

The President likewise announced the calling of general elections for March 10, 2024. The year ahead is thus sure to provide for interesting developments with Portugal continuing to seek attracting foreign investors and a new government coming into office.

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