



FMA Information about Subordinated Loans

What is a subordinated loan?

A subordinated loan is a loan in which the lender accepts being subordinate in rank to the other creditors. The investor accepts that in the event of the borrower becoming insolvent, they will only get their money back, once all other creditors have received their money back ("subordination clause").

Consequently, there is a particularly high risk of there not being any more money available for paying out the subordinated creditors. Subordinated loans therefore frequently promise higher rates of interest than classical loans, since an increased risk exists of not receiving any money back.

An investment in the form of a subordinated loan is subject to a high level of risk, and may also lead to a total loss of the investment.

What is a qualified subordinated loan?

In the case of qualified subordinated loans, the borrower shall not be required to pay out despite payment becoming due, if such a pay-out could cause the borrower to get into serious financial difficulties. The lender may also not demand repayment of the loan and the payment of interest while such payments could trigger the insolvency of the borrower.

When does an obligation to publish a prospectus exist for a subordinated loan?

The commercial issuance of subordinated loans constitutes a banking transaction, and is therefore only allowed to be conducted by banks. However, the claims of the lender are excluded from the scope of coverage of deposit guarantee schemes. Qualified subordinated loans generally do not constitute banking transactions, and therefore is therefore neither an obligation to publish a prospectus, nor any deposit protection.



What additional risks are attached to gualified subordinated loans?

In the case of some currently prevalent subordinated loans, while the business risk is passed on to the lender, the lender does not get to participate in the lender's commercial success! Generally no rights of information and control are agreed upon. It should in any case be possible for lenders to inform themselves in a reliable manner about their rights and obligations as well as about the financial situation of the entity that is borrowing, for example by consulting the general terms and conditions or the quarterly or annual reports.

Such clauses constitute a contractual deviation from the law, which leads to the admissibility of such clauses only being able to be ruled upon by orderly courts under application of the General Civil Code (ABGB; Allgemeines Bürgerliches Gesetzbuch) and the Consumer Protection Act (KSchG; Konsumentenschutzgesetz). The admissibility of a few clauses that can currently be found in the market, is in any case controversial in terms of legal commentary and in terms of case law has not yet been ruled upon by the Supreme Court of Justice. (Ruling of LG ZRS Graz case no. 35 Cg 153/15t, confirmed by the ruling of the OLG Graz of 30.03.2017 case no. 4 R 162/16h)

It is also a typical feature of subordinated loans, that the lender does not receive any kind of collateral. The risk of a total loss of the invested capital amount is significantly higher in the case of a subordinated loan, than for a classical non-subordinated loans or also for bonds. The principle applies that: <u>the higher</u> <u>the income opportunities</u>, i.e. the agreed interest rate, the higher the risk of a loss is.

The risk of a total loss for the lender is even higher, and may even occur prior to the actual incapacity to pay of the borrower.

<u>Are subordinated loans and qualified subordinated loans investments that are subject to the requirement to publish a prospectus?</u>

The most recent case law ruling of the Supreme Court of Justice (OGH; Oberster Gerichtshof) (4 Ob 47/16i) about investments defined in the Capital Market Act 2019 (KMG 2019; Kapitalmarktgesetz 2019) is relevant for subordinated loans and allows a strict line to be detected. The OGH ruled in its last ruling that the subordinated loan in question in the case clearly constituted an investment and referred to investment protection.

On the basis of this decision by the Supreme Court of Justice, all subordinated loans are now to be considered as investments as defined in the KMG 2019. This means: in the case of money being invested in the form of subordinated loans and qualified subordinated loans offered publicly,



they are therefore to be considered as investments as defined in the KMG 2019 that are subject to the obligation to publish a prospectus. Such prospectuses are not however approved by the FMA. Only in particular exceptional cases - such as when far-reaching investor control rights exist - is the categorisation as an investment to be rejected on a case-by-case basis.

Subordinated loans that have already be placed are unaffected by this change to the interpretation of the law, with the new interpretation only applying for new issuances.

What are the effects of the most recent case law ruling by the OGH as well as the enactment of the KMG 2019 and the amendment of the AltFG?

The Capital Market Act 2019 (KMG 2019; Kapitalmarktgesetz 2019) was enacted on 21 July 2019. During its enactment, the Alternative Financing Act (AltFG; Alternativfinanzierungsgesetz) was also amended. The KMG 2019 serves the purpose of supplementing the Prospectus Regulation (Regulation (EU) 2017/1129) and the simplification of prospectus law. The previous differentiation between alternative financial instruments in accordance with the AltFG and securities and investments in accordance with the KMG 2019 no longer applies. The AltFG now refers to the definitions contained in the KMG 2019. Whether the simplified regime of the AltFG may be used depends on the total consideration of the issuance.

The legislative has again confirmed the view of the Supreme Court of Justice and the FMA in the accompanying notes to the law that subordinated loans are to be qualified as investments for which there is an obligation to publish a prospectus as defined in the KMG 2019. Together with the new legal rules, consequently tiered and continuous transparency and information requirements are also guaranteed for subordinated loans:

- Under € 250,000: neither an information document nor a prospectus is necessary
- Between € 250,000 and € 2 million: information document in accordance with the AlfFG
- Between € 2 million and € 5 million: simplified prospectus pursuant to Schedule D of KMG 2019 or optionally a full investment prospectus in accordance with Schedule A KMG 2019
- Over € 5 million: full investment prospectus in accordance with the KMG 2019

Investor protection instruments as a result of the obligation to publish a prospectus:

• There is a legal information obligation. The investor must receive information. This information must be published in the prospectus in a standardised format.