

FMA INFORMATION ABOUT SUBORDINATED LOANS

WHAT IS A SUBORDINATED LOAN?

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

Consequently, there is a particularly high risk that there is no longer any money available to pay out subordinated creditors. Subordinated loans therefore frequently promise higher rates of interest than classical loans, since there is 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, where such a pay-out might cause the borrower to get into serious financial difficulties. The lender may also not demand repayment of the loan and the payment of interest where such payments could trigger the borrower's insolvency.

WHEN IS A SUBORDINATED LOAN OBLIGED TO PUBLISH A PROSPECTUS?

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

WHAT ADDITIONAL RISKS ARE ATTACHED TO QUALIFIED SUBORDINATED LOANS?

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

Such clauses constitute a contractual deviation from the law, with the admissibility of such clauses having 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 currently seen in the market is in any case controversial in terms of legal commentary and case law where there is no existing ruling 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 lenders do not receive any kind of collateral. The risk of a total loss of the invested capital amount is significantly higher for a subordinated loan, than for a classical non-subordinated loans or for bonds. The principle in any case applies that: the higher the income opportunities, i.e. the agreed interest rate, the higher the risk of a loss is.

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

ARE SUBORDINATED LOANS AND QUALIFIED SUBORDINATED LOANS INVESTMENTS THAT ARE REQUIRED TO PUBLISH A PROSPECTUS?

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. In its latest ruling, the OGH ruled that the subordinated loan in question clearly constituted an investment and referred to investment protection.

As a result of this decision by the Supreme Court of Justice, all subordinated loans are now considered as investments under the KMG 2019. This means **in the case of monetary investments in the form of publicly offered subordinated loans as well as qualified subordinated loans, they are therefore considered as investments that are required to publish a prospectus under the**

Capital Market Act 2019 (KMG 2019). However, such prospectuses are not 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 been 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 AND 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. At the same time, 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 legislator 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 AltFG
- Between € 2 and € 12 million: simplified prospectus pursuant to Schedule D of KMG 2019 or optionally a full investment prospectus in accordance with Schedule A KMG 2019
- Over € 12 million: full investment prospectus in accordance with the KMG 2019

Investor protection tools arising from 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.