CEE Finance and Capital Markets 2023-2024

The Impact of Regulation

Freshfields Bruckhaus Deringer

Introduction

In the dynamic landscape of central and eastern Europe (CEE), where legislation and financial markets are in constant evolution, Freshfields Bruckhaus Deringer are pleased to present an update on the emerging market and legal trends across the CEE financial markets sectors in collaboration with the leading local law firms, after two days of insightful discussions, networking and celebration.

For 15 years now, the Banking and Finance workshops have been a cornerstone of fostering collaboration and knowledge exchange among the region's leading firms. This year, we also proudly celebrate a decade of the Capital Markets workshops, a testament to the enduring relevance of this forum.

In 2023 particularly numerous changes in the regulation and evolution of financial services have been introduced across the region. The articles presented henceforth in this brochure offer a glimpse into the critical regulations and developments shaping the legal landscape and how these changes are impacting the banking, finance and capital markets sectors across central and eastern Europe.

Moving beyond the emergency

The situation in Ukraine continues to cast a long shadow on the region and the aftermath of the COVID-19 pandemic is still being played out.

Responses to an economic downturn include Ukraine's significant regulatory transformations. Exemptions to currency control restrictions will provide limited flexibility and focus is now shifting to the gradual modernisation of the financial industry through regulations for financial services, payment services, capital markets and virtual assets. These measures should ensure equal access, market transparency and client protection to attract investments, improve capital market efficiency and establish a resilient financial framework - aims which countries across the CEE region share.

However, some remain focused on short-term interventions. The Hungarian Government declared another state of emergency in May 2022, which may be extended until November 2023. The state of emergency has brought new restrictions and rules, which can be a barrier to new financings or the restructuring of an existing financing. This is further complicated by the difficulty of adapting to a changing legislative environment, particularly in respect of the creation of security interests in Hungary.

In Poland, following the Polish Credit Holidays Act 2022 which permitted households to suspend some credit instalments, interest among Polish banks in bond issuances has increased which has prompted the introduction of a legal framework allowing Polish banks to issue contingent convertible (CoCo) bonds.

Closer to the EU

While creating other obstacles, such emergency responses have staved off widespread economic turmoil. But a general malaise is resulting in distress, prompting some to consider their insolvency legislation in order fully to comply with EU regulations. Slovenia, for example, is paving the way for new restructuring tools with a proposed amendment of the Insolvency Act to encourage a more responsible approach. Arranging for a timely and orderly winding-up should result in better repayment of creditors, as will the sale of the debtor's business as a whole, publishing sales in bankruptcy proceedings on a single sales portal, selling assets through online public auction and allowing appeals on points of law.

In other areas, too, the CEE region continues to strive to move closer to EU norms.

The Czech Capital Market law is expected to undergo a significant change in the coming year, particularly with the introduction of a long-term investment product (the LIP), which is similar to the personal retirement savings accounts common in a number of other countries and will likely be introduced in 2024. This Czech law is a crucial step in stimulating investor interest in the capital markets and in increasing the current number of about 35 per cent. of Czech investors in the capital markets.

Bulgaria is also pushing ambitious reforms. A recent change to the legal framework related to corporate financing aims to address longstanding shortcomings hampering early-stage, growth and mezzanine financings. A new type of commercial company, the variable capital company (or VCC), is expected to facilitate investors' provision of more structured products, such as tranched equity rounds or investments that may be drawn when and if needed.

Exploring new paths

Similar opportunities and challenges are evident in continuing efforts to put in place regulation to digitise the banking sector, and deliver FinTech innovation and new capabilities.

Slovakia, for instance, has been paying close attention to the European Commission's 2020 Digital Finance Strategy for the EU and EBA's 2022 Guidelines on the use of Remote Customer Onboarding Solutions. Missing elements within the Slovak regulatory framework to align with EU standards are being addressed by the cautious adoption by Slovak financial institutions of remote customer onboarding, although significant challenges in adapting internal policies and procedures, reliance on third parties, IT and security risks remain.

Turkey is developing a legal framework to address new technologies and international practices, with updates to Turkish payment services legislation, recognition of open banking activities, digital banks and Banking as a Service.

The banking landscape in Romania is also undergoing a transformative shift as the Romanian legislature takes steps to regulate the rise of digital-only banking and fintech, which is offering customers convenience, accessibility and innovative services.

The focus on ESG we noted last year continues with public and private actors mobilising to accelerate the green transformation, and potential for financial services to play a leading role in building a more sustainable economy. Like many other countries, Serbia's traditional reliance on government support for renewable energy project financing has been shifting towards market-based incentives, including market premiums and commercial power purchase agreements. These pivotal changes were initially recognised in a 2021 law, which was subsequently amended in 2023.

These developments demonstrate the sector's ability to look beyond the seemingly ever-present uncertainty and volatility and to seek out the opportunities for a better future.

As finance lawyers we need to keep up with the regulation and evolution of financial services. Following from that is the analysis of the effect such changes may have on the financial markets. We have therefore compiled the following articles from firms within our **Stronger**Together network who are attending the CEE Finance and Capital Markets Workshops 2023. We express our sincere gratitude to all **Stronger**Together colleagues for their contributions and wish you an interesting read.

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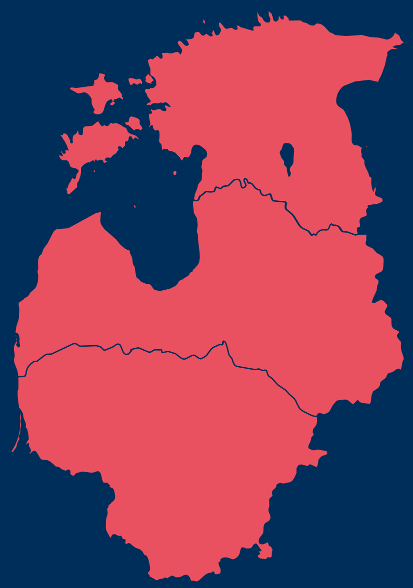

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Baltics

Regulation of remote onboarding in Baltic states

The prevalence of remote work and use of various digital services has significantly increased over the last few years. The Baltic states have managed to capitalise on the emerging trends and are steadily becoming a recognised start-up and fintech hub. Even now, in 2023, the region is becoming increasingly desirable for financial institutions looking to take advantage of the vast amount of progressive technical and legal opportunities. The advancement of technology has enabled financial institutions in the Baltics to offer remote onboarding services by which a customer's identity is verified and established typically through digital means. Remote onboarding has become increasingly popular due to its convenience and efficiency. With this short article, we aim to: (i) describe the strengths of the financial sector within the region; (ii) outline the key principles of remote identification; and (iii) elaborate on new tendencies and developments in the financial landscape of the Baltics.

1. Main economical strengths of the Baltic region

Lithuania, the largest Baltic country, has emerged as a leading hotspot for fintech innovation, particularly in the wake of Brexit. The progressive regulatory environment of Lithuania encourages investors from home and abroad. Post Brexit, Lithuania has become the largest European fintech hub in terms of the number of licensed entities, operating as a gateway to the European market for international fintechs. Access to the market and the Lithuanian digital infrastructure have been named as the main reasons for overseas fintechs to establish a presence in Lithuania. Notably, the Bank of Lithuania has strived for innovation and, throughout 2022, pursued numerous initiatives to boost competition, increase access to services and strengthen capital markets. CENTROlink, a payment system operated by the Bank of Lithuania that provides access to the Single Euro Payments Area (SEPA) for credit institutions and licensed payment service providers, has been actively used by both local and foreign payment institutions.

Latvia is also regarded as an attractive destination, especially for international organisations looking to expand into Eastern Europe. Many international businesses, including those in the financial sector, have recognised the advantages offered by Latvia and have established their central offices there, so it is a prime location for regional Baltic headquarters. The capital city, Riga, often serves as the operational centre for Baltic arms of global corporations because of its central geographical location in the Baltics, further highlighting the country's significance in the region. The presence of international organisations' headquarters also attracts providers of financial services.

Estonia, a small and tech-savvy country which is the home of more than 10 unicorns, has become a global leader in digital innovation. The ground-breaking e-Government initiatives offered by Estonia have streamlined bureaucracy significantly. Most notably, the country has developed an e-Residency program based on which: (i) entrepreneurs from anywhere in the world are able to easily establish and run a global business from Estonia; and (ii) every e-Resident is issued a digital ID that can be used for remote identification purposes. Moreover, Estonia stands out in the region as being one of the first jurisdictions globally to introduce rules applicable to virtual currency service providers, with comprehensive regulations for virtual currency service providers being introduced prior to the EU's enactment of the Markets in Crypto Assets (MiCA) Regulation.

The above-mentioned strengths complement each other and make the Baltic region an ideal environment for many start-ups and fintechs.

2. Key principles and advantages of remote identification in the Baltics

As its strengths contribute to the rapid development therein of the financial sector, the region also needs and has developed effective remote identification tools to match this accelerated pace. While national differences remain, the key principles and advantages of remote identification in the Baltics include:

- *Diverse identification options*

One of the key strengths of the region is the possibility of using a number of different remote identification methods due to the fact that the Baltic states themselves have invested considerable resources in the development of such methods and the required technology. Whether it is the comprehensive electronic identification methods (including ID cards, mobile-ID, and more), video identification or even selfie-based verification, the Baltic countries offer a vast number of options that can be tailored to suit various customer needs and preferences.

- *Compliance with sringent regulations*

In the current digital world, there can be no compromise on regulatory compliance. The Baltic states understand this principle well and have aligned their remote identification frameworks with stringent regulations imposed by the legislators of the EU.

More specifically, all three Baltic countries provide clear regulatory guidelines for remote customer onboarding. These guidelines emphasise the importance of security while allowing businesses the flexibility to adapt and innovate within specifically defined parameters.

- ***Cross-border recognition***

The Baltic approach to digital identification methods aligns seamlessly with EU standards, thus making cross-border business transactions within the EU smoother and more accessible. This compatibility further enhances the region's appeal to international businesses.

The firm commitment to compliance, technological innovation and regulatory guidance positions the Baltic region as a frontrunner in the field of remote identification on the global stage.

3. New tendencies: the Baltics are leading the way in modern and secure remote identification rules

In the evolving landscape of remote identification, the Baltic states can be considered trendsetters. Their approaches to remote identification align with the latest technological advancements while prioritising data security and compliance.

- ***Technological innovation***

The Baltic region has consistently embraced cutting-edge technologies and digital solutions. All three countries offer multiple modern identification methods, including, but not limited to, ID cards, Smart-ID, mobile-ID and other solutions involving usage of mobile devices.

- ***Data security***

While real innovation is certainly a hallmark, security is non-negotiable in the remote identification framework. The Baltic states have stringent data protection measures in place in order to ensure that customer data is safeguarded at every step of the onboarding process (and also during the business relationship). Businesses and their customers are further reassured by the fact that the Baltic states value compliance with EU law, most notably the Regulation on Electronic Identification and Trust Services for Electronic Transactions in the Internal Market (eIDAS) framework. Furthermore, in order to mitigate the possible security risks and threats (such as a cyber-attack or codes falling into the wrong hands), the Baltic governments have a 24/7 Computer Emergency Response Team (CERT) and offer a round the clock' telephone number to suspend identification certificates.

- ***Surpassing global standards***

It's not just about staying abreast of global trends — the Baltic states often set the pace. Their remote identification rules are recognised as some of the most secure in the world. It can be said that the Baltic countries go beyond the minimum requirements in order to ensure that the whole identification process is fool proof and resilient against any emerging threats. These remote identification measures are internationally considered secure enough to enable remote voting to take place. For instance, Estonia has allowed its citizens to vote electronically since 2005. In the last elections, ID-cards, mobile-IDs and digital IDs that are also available for remote identification for the financial sector were used for election identification.

4. Conclusion

The set-up of Baltic states in remote identification demonstrates a combination of innovation and security that surpasses many other countries. The general commitment to staying ahead of the curve makes the Baltic countries frontrunners in the current digital age. The Baltic states demonstrate that it is possible to create methods of remote identification for the financial sector that are both easy to use and secure.

In conclusion, Estonia, Latvia and Lithuania have set a global benchmark for secure and effective remote customer identification methods. Regardless of certain country specificities, all Baltic countries put significant emphasis on data security and regulatory compliance, making the region a testament to the power of innovation and security.

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Bulgaria

New type of commercial company to facilitate venture capital/private equity and mezzanine financings

In July 2023, Bulgaria introduced one of its most ambitious reforms of the legal framework related to corporate financing. With the aim of addressing longstanding shortcomings of Bulgarian corporate law, which were largely considered as hampering early-stage, growth and mezzanine financings, the legislators introduced a new type of commercial company called a variable capital company (***VCC***). VCCs are expected to facilitate the set-up of companies projecting fast growth and relying on the provision of non-bank external financing, both in the form of equity and debt. In this article, we will point to some notable novelties a VCC offers which might benefit venture capital/private equity and mezzanine financing structures.

1. Capital

The main substantial difference between VCCs and the traditional company types of limited liability companies (***LLCs***) and joint-stock companies (***JSCs***) is that VCCs are not required to maintain any registered capital and are thus not subject to any capital maintenance requirements. Further, there is no fixed minimum par value of a VCC's shares, allowing these companies greater flexibility in determining their number of shares and assigning as low a par value as they deem fit. As a result, VCCs will permit investors to provide more structured products, such as tranched equity rounds or investments that may be drawn when and if needed. There will be no longer any requirement for the provision of cash contributions to be proven before the commercial registry and now, such contributions can be made either: (i) directly to the VCC; or (ii) by covering liabilities of the VCC.

An important feature of VCCs is the increased flexibility to receive in-kind contributions. The current framework requires all in-kind equity contributions to be valued by three independent experts appointed by the commercial registry. This has proven to be a time-consuming and greatly inefficient process, mainly due to the fact that the commercial registry uses a system for the random appointment of experts who do not necessarily have the expertise or experience required for more complicated valuations, especially equity valuations. However, for VCCs, the law now allows the valuations of in-kind contributions to be prepared by valuators appointed by the company itself. This feature will significantly facilitate the provision of convertible financing, which was also required to obtain an independent valuation prior to conversion.

2. Convertible instruments

The new regulation now explicitly allows a VCC, if authorised by its shareholders at a shareholders' meeting, to issue convertible instruments and to take convertible loans on the terms and conditions provided in the VCC's articles. According to our reading of the new regulation, the VCC's articles may now provide for the terms of conversion of a convertible loan, including the price of conversion, implying the exclusion of the requirement for a monetary valuation of the loan receivables as an in-kind capital contribution.

3. Classes of shares

VCCs are permitted to issue different classes of shares, including preference shares or redeemable shares. The law does not limit the type of preference rights that may be assigned to preference shares, giving more flexibility to companies and investors in designing the classes of shares and the capital structure. However, it should be noted that shares in VCCs are not recognised as securities and are thus not capable of being listed or traded on a regulated market or a multilateral trading facility, or otherwise publicly offered. The latter limits investment exit strategies unless the VCC is reorganised into a JSC.

4. Redemption of shares

Since VCCs are not treated as corporations (JSCs), a VCC may acquire up to 50 per cent of its own shares (as compared to a 10 per cent limit in a JSC) and will be required to dispose of any number of shares above this value within a three-year period (as compared to one year in a JSC).

VCCs are further granted the option to specify their own valuation method in the case of a redemption of shares, including forcible redemption. By contrast, in the case of an exit by a shareholder of a LLC, whether voluntary or involuntary, the value of their share will be determined based on the balance-sheet value of the company's assets.

5. Share transfer restrictions

One issue that has troubled legal practitioners in Bulgaria dealing with corporate financing has been the enforcement remedy against other shareholders or the company itself of share transfer restrictions or investors' protection rights. The primary issue lies in the uncertainty as to whether a transfer in breach of a transfer restriction renders the transfer itself unenforceable or gives only rise to contractual remedies, such as a claim for damages. The VCC legal regime expressly allows a VCC's articles to provide for various limitations in relation to contemplated share transfers. These may include rights of first refusal, tag-along rights and drag-along rights.

On that level alone, the VCC rules do not appear to have added value. Although legal provisions applicable to LLCs and JSCs do not expressly, or with as much specificity, allow LLC and JSC articles to include similar share transfer restrictions, such restrictions have, in practice, been a common fixture of LLC and JSC articles for a long time based on the parties' contractual freedom. However, it may be argued that the explicit recognition of those restrictions in the VCC legal regime should make them capable of being directly enforced vis-à-vis other shareholders in a VCC and the VCC itself, and not to rely only on contractual remedies.

6. Share options

The new VCC regime expressly addresses the possibility for a VCC to grant employees an option to acquire shares in the VCC. In comparison, the rules applicable to LLCs and JSCs are silent on the matter, thus leaving it as a matter of the parties' contractual freedom. It is too early to speculate whether the new legal provisions will bring added value. Option holders who have exercised their options may not acquire in aggregate more than 15 per cent of all the VCC's shares. No such limit exists for the other two types of companies unless, in the case of a JSC, such JSC is listed on a regulated market.

7. VCC thresholds

It should be noted that the VCC form is available only to businesses with less than 50 employees and less than approximately EUR 2.045 million in terms of annual turnover and/or value of assets. If these requirements are no longer satisfied, the VCC must be reorganised in another legal form.

8. Concluding remarks

As a new company form, the VCC presents certain advantages, in particular more flexibility and broader freedom of action relative to the widely used LLCs and JSCs. At the same time, a VCC's enhanced flexibility is contingent on thoughtfully drafted articles of association.

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The reorganisation of the Pledge Registry

In the ever-evolving legal landscape of Croatia, certain topics require significant attention due to the potential impact on the local market. One example is the Pledge Registry and its role in ensuring legal security for creditors and debtors. Recent discussions surrounding the potential abolition of the Pledge Registry in its existing form have sparked curiosity and concern among stakeholders. In this article, we will discuss the Pledge Registry system in Croatia, highlighting its strengths and weaknesses. Additionally, we will explore the recent publications suggesting the Registry's abolition and examine the potential alternatives or amendments that may shape the future of this critical aspect of the legal framework.

1. Pledges and the Pledge Registry: enhancing creditor-debtor relations

In the financing sector, securing a claim is of the utmost importance for all the creditors, be it banks, other financial institutions, or funds. A considerable part of any financing project (such as acquisitions, infrastructure and energy) is making sure the creditors are sufficiently secured and that in the event of default appropriate recourse is available.

The number and type of security instruments depends on each project, borrower and the assets at disposal. On this basis, the claim can be secured by, *inter alia*, debenture notes, bills of exchange, mortgages, or pledges.

(a) Creation of pledges

Pledging of various types of assets in Croatia is governed by the Ownership Act and the Act on the Registry of Court and Notarial Insurance of Creditors' Claims on Movable Property and Rights (Official gazette no. 121/2005) (the ***Registry Act***).

Under Croatian law, a pledge establishes certain rights over the debtor's property in favour of the creditor. In the event of default, the creditor has the right to settle his claim from the value of the pledged asset. A pledge can be established over movables (such as machines, telecom infrastructure, energy grid, vehicles and cattle), shares, receivables, or sets of assets (located in a warehouse, facility, business premises, stores and the like).

A pledge is first stipulated in the pledge agreement and then registered with the Croatian Financial Agency's (***FINA***) Registry of Court's and Notary's Security Interests of Claims on Movables and Rights (the ***Pledge Registry***).

A pledge agreement governed by Croatian law must be entered into in the form of a notarised deed, certified as to its content before the Croatian notary public. A pledge agreement usually contains an enforcement clause which enables the pledgee/creditor to initiate direct enforcement proceedings for the collection of due and unpaid collateralised claims before the competent court, without the need to first obtain a final and binding court decision through lengthy litigation proceedings.

The security constituted by a pledge is perfected by way of registration with the Pledge Registry. The registration of pledges with the Pledge Registry can take up to eight days as of the proper submission of the application for registration. Once perfected, the pledge exists until its deletion from the Pledge Registry based on the pledgee's release statement.

(b) Enforcement of pledges

The notary public is entitled to issue an enforcement confirmation in respect of the pledge agreement (which means that the agreement becomes enforceable) upon the pledgee's request, after an event of default occurs. In order to obtain such enforcement confirmation, the pledgee must provide the notary public with a certified statement that the event of default occurred and specify the amount of due and unpaid secured claim. Based on the pledge agreement which is marked by the notary with the enforcement confirmation stamp, the pledgee is entitled to initiate the enforcement procedure for the collection of outstanding amounts, either in court or through out-of-court proceedings.

The pledge agreement usually stipulates the out-of-court settlement of the pledgee's claims, which are more beneficial to the creditors because they require less time and resources to be carried on. The pledgee may thus settle its due and outstanding claims by means of a free sale or disposal of the pledged assets without reference to the court or the notary public. The pledgee still has the choice to initiate court enforcement proceedings if it prefers.

Court enforcement proceedings in Croatia are initiated by filing an enforcement application with the court and usually take up to three years depending on the court that would be competent for the enforcement, the workload of the courts and the cooperation of the parties.

(c) Pledge Registry

Since pledges are perfected by registration in the Pledge Registry, the Pledge Registry is crucial to the whole process of collateralising a claim to securing creditors' interests. The registration process ensures the publicity and enforceability of the pledge, providing legal certainty for both the pledgee and other interested parties.

Apart from being mandatory, the registration of pledges offers several advantages. First and foremost, it establishes a priority ranking amongst competing claims over the same asset. This means the first registered pledge enjoys a higher priority over pledges registered subsequently, thus ensuring a better chance of recovery in the case of default.

Additionally, registration of pledges also provides third parties with the ability to conduct due diligence on assets before entering transactions involving such assets. Interested parties, such as potential buyers or lenders, can access the Pledge Registry to verify the existence and extent of registered pledges, helping them to make informed decisions and mitigate risks.

2. Registry shortcomings: addressing challenges for improved efficiency

The characteristics and advantages of the Pledge Registry mentioned above are unfortunately not as present in practice as they are in theory. The Pledge Registry and the whole system envisioned by the Registry Act could benefit from some improvements to optimise the registration process and to establish a link between registered pledges and their enforcement. Some of the most common issues of the Pledge Registry include the:

- administratively burdensome registration procedure;
- lack of digitalisation; and
- poor searchability of the Pledge Registry.

One of the major shortcomings of the Pledge Registry is its administrative burden. The process of registering a pledge requires extensive paperwork and documentation, making it time-consuming and complex. Parties involved in creating and registering a pledge must navigate through various procedural requirements, which often involve multiple stakeholders such as lenders, borrowers, and governmental agencies. This often leads to delays and inefficiencies, increasing the overall cost and efforts associated with creating and managing pledges. In simplifying and streamlining the administrative processes, the Pledge Registry could be made more user-friendly, thus helping alleviate this issue.

Another significant shortcoming of the Pledge Registry is the lack of digitalisation. Traditionally, pledge registration has relied on paper-based systems, which are prone to errors, delays and physical storage limitations. The absence of a digital platform hampers the efficiency and accessibility of the Pledge Registry as it makes it challenging for stakeholders to search and verify existing pledges, leading to potential discrepancies or inconsistencies in the records. Adopting a digitalised platform for the Pledge Registry would enable easier data entry, faster processing times, improved data accuracy and enhanced accessibility for all relevant parties.

The Pledge Registry also suffers from inadequate searchability of public records. Locating and retrieving information about existing pledges can be a cumbersome task, primarily due to the lack of user-friendly search functionalities. This hinders transparency, impedes due diligence processes, and creates uncertainty in commercial transactions. Implementing an advanced search system that allows users to locate relevant pledge records quickly and accurately would greatly enhance the usability and reliability of the Pledge Registry.

Addressing these shortcomings would require implementing reforms that streamline administrative processes, introduce digitalisation, and enhance the searchability of the public registry. This would render the Pledge Registry more efficient, accessible and reliable, ultimately facilitating smoother business transactions and reducing the associated burdens for all stakeholders involved.

3. The future of the Pledge Registry: abolishment rumours and potential alternatives

The matter of the potential reorganisation of the Pledge Registry first caught our attention when the government published its annual Plan of Legislative Activities for 2023 on 29 December 2022. The statement of its intention to abolish the Registry Act was reminiscent of speculation in 2021 on discontinuing the Pledge Registry due to its inefficiency and costliness. Two years later, the Pledge Registry is still in existence and there are some new plans to tackle its shortcomings instead.

Having since investigated the situation and attempted to find out what the legislative plans are after the announced abolition of the Pledge Registry, we have contacted the competent authority that manages the Pledge Registry and the Ministry of Justice. From the information we obtained, it follows that all stakeholders are aware of the Registry's shortcomings and the need to ensure its optimisation. It seems that the idea of abolishing it completely is gradually being abandoned and that they are now leaning towards the option of amending the existing system.

However, after the introduced initiative and the legal proposal that the Ministry of Justice received from FINA, the competent authority, which they responded to, it seems the legislative procedure (for either the abolishment or the transformation of the Pledge Registry) has been put on hold. It is expected that the public consultation on the proposal of the new law or the proposal of amendments to the law could be opened after the summer of 2023.

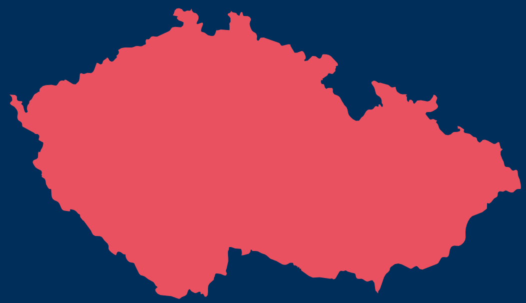
4. Foreseeable changes on the horizon

Addressing the shortcomings of the Pledge Registry could be achieved through either: (i) amending the Registry Act; or (ii) the introduction of entirely new legislation specifically designed to rectify these issues.

First, amendments to the Registry Act could focus on streamlining administrative procedures, simplifying documentation requirements and reducing the overall burden associated with registering a pledge. Secondly, digitalisation of the registry could be facilitated by introducing provisions that mandate the development and implementation of a digital platform for pledge registration.

Lastly, to address the poor searchability of the public registry, amendments or new legislation could establish comprehensive search functionalities, including advanced filtering options, keyword searches and standardised indexing systems. Whether through amendments or entirely new legislation, these proactive measures would ensure that the Pledge Registry is modernised, user-friendly and capable of meeting the needs of stakeholders in a rapidly evolving business landscape.

Going forward, we expect the Government to open a public consultation in September 2023, either for the amendments to the Registry Act, legislation replacing the same or (least likely) establishing an entirely new system for the registration of pledges.



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Capital Market law reforms ahead – will a new investment product become a game changer for the Czech financial market?

The Czech Capital Market law is expected to undergo a significant change in the coming year, particularly with the introduction of a long-term investment product (the ***LIP***), which is similar to the personal retirement savings accounts common in a number of other countries. Market participants, economists, the government and the general public all have high expectations. In this article, we will look at the legislative proposal for the LIP currently on the negotiation table of the Czech legislator and the impact it is expected to have, if adopted, on the Czech financial market.

1. Introduction

In May 2023, the Czech government proposed a long-overdue amendment to legislation aimed at the development of the local capital market. The Czech Parliament is currently debating a capital market law reform that will change the way retail pension savings are managed while introducing the LIP. This will significantly transform the way in which Czech citizens save for their retirement. It is expected that the amended law will be adopted and enter into force on 1 January 2024.

2. Background

Currently, there are three state-supported retirement savings products in the Czech Republic. The state supports them through tax reliefs and/or financial contributions. State-supported retirement saving products are long-term investment products that are part of the Czech social security system to ensure a higher standard of living in retirement. These products accumulate current investments totalling more than EUR 24 billion:

- pension insurance funds
- supplementary pension savings funds; and
- life insurance products

(collectively ***tax-supported savings products***).

The new type of retirement savings product — the LIP — will most likely be introduced in 2024. It aims to improve weaknesses of the existing retirement savings products, namely, low profitability for investors, limited product choice and the absence of any possibility to follow personalised investment strategies.

The LIP focuses primarily on investors aiming for more diversified asset strategies as well as personalised investment approaches. The LIP creates much more room for investors to select their own strategy, depending on their risk appetite, which brings the potential for higher profits. Yet, by using the LIP, investors will not benefit from any guarantee provided by the state for investment returns. The LIP is thus a significant change from current tax-supported savings products, which are strictly limited by law in terms of risk and types of assets.

3. Key features

(a) What changes for investors?

The LIP is a product which may include any of the following assets:

- cash deposits;
- investment securities;
- collective investment securities;
- money market instruments; and
- derivatives (to hedge against interest rate or currency risk).

The supplementary pension savings scheme already allows for investments in the types of assets listed above, however, it is restricted to types of investment strategies which allow for the investment to qualify as a undertakings for collective investment in transferable securities fund. As opposed to that, the LIP will not limit investment strategies in any specific way and will not prescribe investments into specific assets and their proportion in the LIP portfolio of an individual investor.

The administrator of the LIP may provide services to the investor in accordance with the scope of its business licence, relevant regulations and the customer agreement. These services may include, for example, (individual) portfolio management, investment advice and execution of orders.

The current financial services regulation applicable to the provision of investment services shall apply to the services related to the LIP. This includes complying with key requirements such as the general requirement to act in the best interest of the customer, information obligations, and requirements related to conflicts of interest, inducements, assessments of suitability and appropriateness, or product governance, among other things (to the extent applicable).

The fee structure for LIPs still needs to be clarified. According to the proposal, financial service providers should be prohibited from charging specific fees for management and related services in respect of the LIP, however, the investor will not be able to avoid individual charges linked to specific investments, such as entry charges and individual transaction fees.

An investor may claim tax relief for his LIP investments from the first day of the product's existence as part of his annual tax return. The following conditions must be met, otherwise the investor must repay the tax benefit he has received from the state by way of tax relief:

- the investor's investment in the product has lasted for at least 120 months from the product's establishment; and
- the first payment from the LIP will be made on or after the day the investor reaches the age of 60.

An employer who contributes to his employee's LIP can also claim a tax deduction.

(b) Who will be able to provide the LIP?

It is envisaged that the scope of financial institutions that will be eligible to manage the LIP should be broader and shall also include foreign companies. Specifically, the following financial institutions should be eligible to manage the LIP:

- banks;
- credit cooperatives;
- investment firms;
- fund management companies and self-managed investment funds; and
- foreign companies with a similar licence authorised to provide services in the Czech Republic.

The proposed bill requires that individual clients shall appoint only one manager of their LIP. The proposed bill does not require a special licence for the management of the LIP, which is different to the current supplementary pension savings funds. However, there is a requirement for a LIP manager to notify the respective tax authority of the commencement of management of LIPs.

In our opinion, given the broad scope of entities authorised to provide the LIP it is unlikely that all of these entities are capable of providing the LIP successfully. This may particularly apply to credit cooperatives, which are authorized to provide only a very limited scope of banking services. Therefore, credit cooperatives are not likely to offer an attractive product for investors in terms of diversity of investment strategies. Also, individual self-managed investment funds typically can only provide prospective investors with a limited range of investment strategies.

4. Expected market implications and outlook

The introduction of the LIP is likely to increase the total amount of investments in retirement savings products and will make retirement savings products more attractive for investors. As outlined above, it is expected that most of the financial institutions present in the local market will consider participating in the forthcoming LIP regime by offering LIP products. As such, this will bring a unique opportunity for market players with a view to expanding their businesses, particularly because in comparison to the tax-supported savings products currently available on the local market, a broader range of financial institutions (including foreign providers) will be allowed to manage LIPs. This is highly likely to make retirement savings products more attractive and accessible, as well as increase competition in this market segment.

The LIP brings new opportunities to the market for financial products with a long-term investment horizon whose primary objective is to secure a comfortable retirement lifestyle. It will further expand the investment choices for new and existing investors of tax-supported savings products. Investors who already invest in supplementary pension savings will also be motivated to invest into the new product, as they will retain the option to save with state contributions and tax deductions, which will be doubled thanks to the reform and could be applied to both products.

The LIP is not only important for the retirement savings product market but is a crucial step in stimulating investor interest in the capital market itself. So far, only 35% of Czech citizens have been investing in the capital market. However, the introduction of the LIP has significant potential to increase this number. In our opinion, the LIP can truly become a game changer on the Czech capital market and represents a momentum for a fundamental mind-set change of Czech citizens towards investments in general.

Hungary

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Warning for lenders and investors: important changes relating to new financings and restructurings and new legislation facilitating investment into government bonds

Hungary has recently implemented several significant changes in its legislation and practices concerning new financings and the restructuring of finance documents. These updates have implications for both Hungarian and cross-border lenders operating in the country. Key areas affected include foreign direct investment (***FDI***) requirements and requirements relating to taking security.

Beyond that, new legislation was adopted in Hungary directing investment of both institutional and private investors towards Hungarian government bonds, thus financing the country. Such changes include both new regulatory requirements and taxation changes, which are applicable very broadly.

1. Finance – Important changes concerning both new financings and restructurings

In this section we have summarised some of the new key concerns and suggest that these be observed by the parties in relation to new financings and amendment / restructuring of existing financings.

Some of these concerns arise in connection with the state of emergency in Hungary. The Hungarian Government declared another state of emergency on 25 May 2022 due to the war in Ukraine. According to the Fundamental Law of Hungary, the Government — with the authorisation of Parliament — may decide on the extension of the state of emergency if the circumstances giving rise to the declaration of the state of emergency persist. Based on Act XLII of 2022, the Government is currently authorised to extend the state of emergency until 25 November 2023. Based on the practice followed in recent years by the Government of Hungary, including several extensions, it cannot be excluded that — with new authorisations — such deadline will be further extended. During a state of emergency, the Government is authorised to pass government regulations suspending certain laws or temporarily derogating from the provisions of laws and take other extraordinary measures.

(a) Default interest cap

In Hungary, contractual interest rates are typically capped in certain consumer loans and SME loans. However, the Hungarian Government has recently introduced a hard cap on default interest. Pursuant to that, as long as the state of emergency exists in Hungary, the rate of the default interest may not exceed 25 per cent p.a. As a result of this measure, any default interest exceeding the prescribed cap will not be enforceable against or payable by the borrower and other obligors.

(b) New security interests – FDI requirements

When a Hungarian entity is requested to provide security, whether as part of a new financing arrangement or during the restructuring of existing facilities, parties must consider the implications of FDI clearance measures. Previously, these measures were applicable primarily to traditional M&A transactions, but recent changes extend their scope to include security agreements.

Beyond the acquisition of shares in a strategic company, the FDI procedure shall also be conducted, among others, if the following conditions are met

- the assets (infrastructure, equipment or other assets) or the assets' use right or operation right were transferred, or if there was security created over certain assets;
- the assets are indispensable for the operation of the strategic activity; and
- the acquirer is a foreign investor or a person or entity in which a foreign investor has direct or indirect majority influence.

It is worth highlighting that this requirement applies to all "*strategic companies*" or "*strategic activities*". The nature of a Hungarian company is generally described by its activities. If such activities fall within sectors like the energy, transportation, communication or financial sector, a company may qualify as strategic company. Additionally, for the purpose of security issues "*foreign investors*" encompass investors from countries outside the EU, EEA, and Swiss Confederation.

It is important to note that there is no minimum transaction threshold for the FDI clearance rules to apply to security agreement(s) if they meet the requirements set out above. However, only the creation of security over the strategic assets of such companies is subject to FDI clearance. While there is no official binding interpretation, general practice suggests that security over the bank accounts or certain claims/receivables of the strategic companies shall not require an FDI clearance. Similarly, the creation of security over the shares/quotas in such companies shall not require an FDI clearance either.

Should FDI rules apply, there may be a detrimental effect on transaction timing and costs. While clearance should be issued within 30 working days plus a 15 day extension period, it may be longer in practice as the relevant Minister (currently, the Minister for Economic Development) tends to extend the deadline in most cases, delaying the creation of the respective security interests. In addition, all documents should be provided to the relevant Minister for review in the

Hungarian language (i.e. official translations are needed in case of foreign language documents). It should be noted that details of the decision-making process are not publicly available. As the current wording of the relevant laws is quite vague, practice indicates that the relevant notification tends to be filed even if there is doubt whether the FDI regime is applicable.

Failure to comply with the FDI clearance rules may lead to invalidity of the relevant contract, unilateral legal declaration or corporate action.

(c) Recent amendment of the Hungarian Civil Code concerning the creation of pledges/mortgages

Until recently, it was possible to determine the secured obligations in a pledge or mortgage agreement by any way suitable for the identification of the secured claim. Notwithstanding this, it was possible, without prejudice to the determination of the secured obligations, for the parties to determine the maximum amount up to which satisfaction could be sought from the pledge or mortgage. However, to enforce and strengthen the principle of publicity, in particular to protect junior security beneficiaries and other third parties, the Civil Code was amended recently in this respect.

Since 24 June 2023, the maximum amount has become a key element in the definition of secured obligations. According to the amended text of the Civil Code, secured obligations may be determined or defined as follows: (i) either by reference to one or more underlying legal relationships and to the amount of the claim, or (ii) by reference to one or more underlying legal relationships and to the amount up to which the pledgee may seek satisfaction of the pledge or mortgage (i.e. the maximum amount). With this amendment, the maximum amount has essentially become a defining element of secured obligations, the absence of which may render the security invalid. In practice this means that (if option (ii) above has been selected) security agreements will always set out a maximum amount limiting the enforcement of the security to such maximum amount.

However, the rules for each relevant registry have not been amended and adapted to these amended rules as of the date of this article. This means that, for example, the Company Registry can only indicate the pledgee or the security agent, but the amount of either the secured obligations or the maximum amount cannot be indicated as of August 2023.

2. Capital Markets - New laws directing investors towards government bonds

One of the hot topics in Hungary in the summer of 2023 has been the introduction of local regulations affecting the structure of residential and institutional savings, both directly and indirectly. On 31 May 2023, the Hungarian Government issued four decrees collectively aimed at encouraging investments in government securities from both households and the financial sector (the ***May 2023 Regulatory Package***). To this end, the Government turned to a wide range of tools: from introducing tax measures to forcing banks to advertise government bonds among their clients.

(a) Investment rules of certain investment funds

Effective from 1 July 2023 and throughout the state of emergency, the Government Decree on Investment Rules of Certain Investment Funds requires that bond funds, equity funds and mixed funds hold at least 60 per cent of their portfolio assets in securities. In the May 2023 Regulatory Package, further restrictions and requirements were introduced as to the weight of certain assets within the portfolio. Since 1 August 2023 securities funds are restricted from investing more than 5 per cent of their assets into debt securities not denominated in Hungarian Forints (***HUF***). However, investment into certain debt securities, (for example, debt securities issued by a specialised credit institution) is excluded from this restriction.

Furthermore, securities funds and real estate funds shall hold at least 20 per cent of their liquid assets in discounted Treasury bills issued by the Hungarian State. As explained by the Government, this measure aims to channel the assets of the funds currently held in cash and bank deposits into T-bills.

These new requirements do not apply to securities funds whose fund management and investment policy stipulates that at least 80 per cent of their portfolio shall consist of instruments issued and distributed outside Hungary.

The Government intends to keep these rules even after the state of emergency so in the near future the relevant permanent laws are expected to be adopted. Nonetheless, the special law-making regime provided under the state of emergency facilitated swift action from the Government.

(b) New tax on investments

Another element of the May 2023 Regulatory Package is the introduction of a 13 per cent social contribution tax, payable by private individuals after interest income realised on certain types of investments. The investments subject to this new tax include:

- interest earned on deposits and current accounts after 1 July 2023;
- interest paid on term deposits deposited after 1 July 2023; and
- profits from the sale or redemption of, and interest paid on, publicly issued and traded debt securities and units of collective investment funds (excluding real estate funds) acquired by the investor after 1 July 2023.

This type of income is already subject to a 15 per cent personal income tax, thus, the overall tax burden on this investment-related income now amounts to 28 per cent.

Importantly, income realised on Hungarian government bonds targeted to retail clients is exempted for both the personal income tax and the newly introduced social contribution tax.

(c) Banks to send government bond DM letters to clients

Pursuant to the Government Decree on Financial Education Awareness Campaign on Savings for Household Customers, also issued in the May 2023 Regulatory Package, Hungarian credit institutions are now obliged to send an awareness notification to all private individual clients holding a bank account with them. This notification should showcase potential gains that clients could have realised had they invested HUF 100,000, HUF 500,000 or HUF 1,000,000 (approximately, EUR 250, EUR 1.250 or EUR 2,500 respectively) into Hungarian retail government bonds during the relevant period. Additionally, it must provide information on possible gains that could have been achieved, had amounts been deposited at the average annualised interest rate on HUF household deposits.

While it is true that raising financial awareness is a valid objective *per se,* it is hard to interpret the decree to mean anything other than conveying a message to account holders that they are better-off if they keep their savings in Hungarian government bonds and not with the banks.

(d) Discount in extra profit tax if banks invest into Hungarian government bonds

Pursuant to a Government decree issued in June 2022, financial institutions were ordered to pay a special tax for the tax years 2022-2023 in order to "support the balance of public finances". A fourth decree in the May 2023 Regulatory Package extended this obligation to the tax year of 2024. Additionally, a new incentive was introduced to encourage financial institutions to invest their own assets in long term Hungarian government bonds. The incentive works as follows: if the average daily stock of government bonds held by a financial institution on its own account between 1 January 2024 and 30 November 2024 increases compared to its average daily stock of government bonds between 1 January 2023 and 30 April 2023, the financial institution is entitled to reduce its special tax liability by 10 per cent of the increase in the value of its government bond investments. However, for this incentive calculation the financial institution can only consider Hungarian treasury bonds denominated in HUF and with a maturity date falling after 1 January 2027.

3. Conclusion

The state of emergency has brought with it a number of new restrictions and rules, which in themselves can be a barrier to new financings or to the restructuring of an existing financing. A further challenge is the difficulty of adapting to a changing legislative environment, in particular in relation to the creation of new securities in Hungary. The most influential amendment is the FDI regime, which means that in certain cases the transaction must be communicated to the Ministry for Economic Development and can only be carried out with the approval of the relevant Minister, failing which the security is null and void.

The new capital market governmental measures have a clear message - invest into government bonds. If successful, the State stands to benefit greatly. It is projected that investment funds may contribute an additional HUF 500 billion (approximately, EUR 1.25 billion), while banks can add another extra HUF 1300 billion (approximately, EUR 3.25 billion).

These measures affect both private and institutional investors. The introduction of the 13 per cent social contribution tax basically doubled the tax burden on investments. Coupled with the State Treasury's offer of free accounts and other benefits offered by the May 2023 Regulatory Package in respect of government securities investment, investment service providers and fund managers face a challenge in offering competitive investment alternatives.

Poland

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CoCo bonds for Polish banks – a new legal framework

More than a decade after Regulation (EU) No. 575/2013 (the ***CRR***) had entered into force, the Polish legislator amended the Polish Act on Bonds, the Polish Banking Law and several other acts by way of an amending act (the ***Amending Act***) in order to introduce a legal framework allowing Polish banks to issue contingent convertible (***CoCo***) bonds, that is, instruments that can be qualified as Additional Tier 1 (***AT 1***) capital. Consequently, since 1 October 2023, Polish banks have been able to issue CoCo bonds.

In the following, we summarise key points of the new framework and how it impacts the financial market in Poland.

1. Specific features of Polish CoCo bonds

The CRR sets forth certain criteria that instruments issued by a bank must meet in order for them to qualify as AT 1 instruments. By way of the Amending Act, a legislative framework has been created that allows Polish banks to issue instruments meeting these criteria. Before its entry into force on 1 October 2023, Polish regulations had not explicitly allowed the issuance of CoCo bonds; rather, they had contained obstacles preventing such issuance.

Taking a look at the new framework, Polish regulations now generally follow the requirements regarding CoCo bonds as specified in the CRR, however, certain specifics have also been introduced. In particular, during the drafting of the Amending Act, the authorities responsible for the supervision of financial markets had repeatedly indicated that, in their view, CoCo bonds should not be purchased by individual investors who are unaware of the risks associated with investing in this type of instrument. In order to address this concern, a number of safeguards have been implemented:

- First, Polish law provides that only professional clients within the meaning of MiFID II can subscribe for or purchase a CoCo bond, and the distribution of such products to other clients is prohibited. However, the term "professional client" in the Amending Act does not encompass clients who may be treated as professional clients on their own request (i.e., only per se professional clients are in scope, while elective professional clients cannot subscribe for or purchase CoCo bonds).
- Secondly, the nominal value of each CoCo bond must be at least PLN 400,000 (approximately EUR 90,000) in order to prevent small investors from acquiring such an instrument.
- Thirdly, the terms and conditions of CoCo bonds must disclose the risks connected with investing in AT 1 bonds. In particular, an issuer should describe the risks associated with the occurrence of a trigger event and connected with the cancelation of distributions (interest) on the bonds for an unlimited period and on a non-cumulative basis.

Moreover, in order to protect the interests of minority shareholders, the issue of bonds providing for the conversion of AT 1 bonds into Common Equity Tier 1 (***CET 1***) instruments upon the occurrence of a trigger event requires a resolution of the general meeting adopted by a 75 per cent majority. Such resolution should address several aspects, including (among other things) the maximum size of the issue, the maximum amount of the share capital increase upon conversion, the method of conversion into shares (as well as their type and how to determine their price), and the procedures in the event of a transformation, division, merger or liquidation of the issuer, or a change in the nominal share value before the trigger event.

2. CoCo bonds issues governed by foreign law

The framework as introduced by the Amending Act allows banks to issue CoCo bonds both under Polish and foreign law. However, a noteworthy difference is that CoCo bonds issued under foreign law may only provide that upon the occurrence of a trigger event, the principal amount of the bonds will be written off. The conversion mechanism for such bonds is excluded. Consequently, CoCo bonds issued under foreign law cannot be converted into CET 1 instruments if a trigger event occurs.

The possibility of issuing bonds under foreign law should be viewed positively. The Polish capital market is shallow, and therefore attracting investors involves going to European markets. It seems that European investors will have a greater understanding of securities governed by a system of law they are familiar with. On the other hand, limiting issuances under foreign laws to bonds with a write-off mechanism could potentially lead to higher costs for Polish banks trying to raise capital by issuing CoCo bonds. In the AT 1 market, a trend can be observed that bonds providing for write-offs carry higher interest rates than bonds allowing for conversion where a trigger event occurs.

3. Predictions for the future

Recently, there have been legislative developments and court judgments affecting the capital position of Polish banks.

On 29 July 2022, the Polish Credit Holidays Act came into force, permitting households that had concluded a credit contract denominated in Polish zlotys before 1 July 2022 to suspend due credit instalments for up to eight months. The term of such loans will be extended for the period of which the borrowers suspended their loan instalments. Credit holidays are a form of support provided by the government to help borrowers with the significant rise in interest rates in Poland over the last several years. The Polish Bank Association estimated that banking sector write-offs connected with credit holidays amounted to PLN 13 billion (about EUR 2.9 billion).

On 15 June 2023, the Court of Justice of the European Union (the ***CJEU***) ruled that in the context of an annulment of mortgage loans vitiated by unfair terms, Directive 93/13/EEC does not allow banks to seek compensation from the borrower going beyond the reimbursement of the capital of the credit agreement.

In other words, in such cases loans may be free of charge for borrowers (who may seek compensation from banks going beyond the reimbursement of the monthly instalments and expenses paid in the performance of the credit agreement). It is estimated the potential losses of the Polish banking sector resulting from said judgment may be as high as several dozen billion Polish zlotys.

Although the capital position of Polish banks remains strong, both the credit holidays and the CJEU judgment may result in higher provisions of Polish banks and the need for additional sources of capital.

In light of this, the introduction of AT 1 bonds is an interesting development, providing a new way of raising capital besides equity issuances.

4. Outlook

Against the background set out above, we would expect that certain Polish banks may be interested in AT 1 bond issuances. Despite the disadvantages highlighted earlier, the terms and conditions of AT 1 bonds will most likely be governed by foreign law in order to attract European investors.

It is difficult to determine whether such CoCo bonds will be met with interest from investors. AT 1 bonds generally have a comparatively higher-risk profile, which may discourage investments. Yet, given the stability of the Polish banking sector, CoCo bond issues by Polish banks might nevertheless become a success story.

Romania

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Romania

Digital-only banking in Romania: Exploring the role of fintechs on the Romanian consumer finance market

The banking landscape in Romania is undergoing a transformative shift with the rise of digital-only banking and the growing influence of fintech companies. Enabled by advancements in technology and regulatory developments, fintechs are revolutionising the way financial services are delivered to customers and are challenging the traditional banking practices in Romania.

In recent years, we have witnessed numerous fintech companies and established banks developing new digital products for their clients, offering customers convenience, accessibility, and innovative services. This article aims to explore the emergence of digital-only banking in Romania, focusing on the key legislation and regulatory developments shaping the industry.

1. Remote customer identification

Digital-only banks operate in Romania under the same legal framework as traditional banks and must comply with the same set of rules and regulations. They are subject to various compliance obligations, including anti-money laundering (***AML***) and know-your-customer (***KYC***) requirements, to ensure the integrity and security of the banking system. Until recently, meeting KYC requirements through electronic means of identification posed challenges as it was unregulated and carried regulatory risks.

The Romanian AML Law included, for the first time in 2020, provisions on client identification performed through:

- a trusted services provider in accordance with Regulation (EU) no. 910/2014; or
- the use of any other remote or electronic identification process which is regulated, recognised and accepted by the Authority for the Digitalisation of Romania (the ***ADR***).

However, the lack of guidelines for authorising and implementing the remote video identification processes deterred banks and other regulated entities from utilising them.

A significant step forward was taken with the entry into force in November 2021 of the Decision no. 564/2021 of the ADR approving the norms regarding the regulation, recognition, approval or acceptance of the remote personal identification procedure using video means (the ***Norm***). The Norm outlines the regulatory framework in Romania for the remote video identification of individuals and it addresses two main aspects:

- the procedure for the authorisation of banks, payment service providers, trusted service providers, third-party identification service providers and other entities for carrying out remote video identification activities; and
- the guidelines for conducting such remote video identification of individuals using electronic means.

When conducting remote video identification, banks have the option to either:

- carry out the remote video identification activity themselves, by first submitting a request for authorisation with the ADR; or
- outsource this step to a trusted service provider or a third-party identity verifier authorised by the ADR (if incorporated in Romania) or notified to the ADR (if authorised in another EU Member State).

In practice, the second choice is more popular since banks are cooperating with fintech companies, as third-party service providers authorised in Romania and other EU countries, in order to perform a full remote onboarding of customers.

The Norm addresses the key challenges faced by traditional identification processes, such as the need for physical branch visits, paperwork, and time-consuming procedures and replaces them with a video call. In other words, this new piece of legislation enables customers to initiate account openings, obtain loans and perform financial transactions conveniently from the confines of their own homes.

2. Payment services: revolution and evolution

Romania has experienced significant changes in payment services legislation, reflecting both revolutionary and evolutionary developments towards open banking and digital payments.

The directive (EU) 2015/2366 on payment services in the internal market (***PSD2***) implemented in Romania through Law 209/2019 (the ***Payment Services Law***), has had a transformative impact on payment services in Romania. It introduced new requirements for payment service providers, including enhanced customer authentication measures, access to account information for third-party providers and increased consumer protection provisions. The Payment Services Law facilitated the emergence of open banking in Romania, allowing authorised third-party providers to access payment account data with customer consent.

From an evolutionary perspective, the Payment Services Law established a new legal framework in Romania for previously unregulated payment services such as account information services and payment initiation services. The law also implemented consumer rights and specific requirements in relation to the framework contract for payment transactions concluded with customers, such as, transparency in fee structures, the obligation to provide customers with information regarding the payment contract in advance, dispute resolution mechanisms and security measures to safeguard customers' data and prevent fraud.

The rise of mobile payments, internet banking applications and fintech innovation have prompted regulatory adaptations to accommodate such developments which also contributed to the development of digital-only banking services. Romanian banks predominantly offer mobile-banking solutions to customers, through which they provide digital-only payment services, account opening services, loan application and intermediation of insurance and investment products. These mobile and internet banking applications are highly regulated by the National Bank of Romania and ADR undergoing through audits and authorisation processes to ensure customer trust and financial stability.

While PSD2 and the Payment Service Law represented major milestones in payments regulation and in opening the banking market to fintech companies, further improvement and evolution are expected. Open banking in Romania is still in the early stages of implementation and had a slow start due to the novelty of the authorisation process, the large volume of regulatory requirements and the large gap between the banks' internal systems and the application programming interface solution proposed by PSD2. However, the anticipated implementation of the third payment services directive and the payment services regulation aims to address these issues. These new European Union legislative drafts, published in June 2023, promise to clarify and resolve matters related to, among others:

- the protection and confidence of payments by improving the application of strong customer authentication methods and extension of fraud identification requirements;
- the enforcement and implementation of the payment services legislation in the Member States by minimising forum shopping and replacing a large part of the PSD2 provisions, which are applicable in each Member State through national transposition, with a payment services regulation which will be directly applicable uniformly to all Member States; and
- the access to payment systems and bank accounts to payment service providers which are not banks.

The above provisions of the third payment services directive will also impact the Romanian current legislation and will be implemented through amendments to the Payment Services Law within the coming years.

3. Remote execution of contracts

Regulating the remote execution of contracts is not a recent development in Romania, as it has been addressed through multiple pieces of legislation in the past decade. As per Government Ordinance 85/2004 concerning consumer protection in relation to the conclusion and performance of distance financial services contracts (***GO 85/2004***), an agreement concerning financial services may be executed remotely, without the handwritten signature of the customer. This can be done through various remote communication methods, such as post, e-mail, or phone call. The agreement is considered executed once the customer receives a confirmation message in relation to the service, such as an SMS or e-mail from the bank confirming the approval of the loan or the opening of the bank account.

However, in practice, the execution of loan agreements and bank account opening contracts has implied the physical presence of the clients in front of the bank's officers and obtaining the written signature of the customers. The lack of practical application of GO 85/2004 stemmed from the inconsistent interpretation of the law by the Romanian courts, in particular in enforcement scenarios, where banks were required to provide evidence of the contract's existence and of the customer's consent. There were Romanian courts that refused to put in enforcement agreements where the consent of the customer was not clearly expressed through a wet ink signature.

The approach changed in the recent years following the increased use of qualified electronic signature. Such signature holds the same legal weight as a handwritten signature in Romania and was recognised by public institutions in 2020. In addition, a decision of the High Court of Cassation and Justice in Romania in 2019 validated the execution of loan agreements remotely in accordance with GO 85/2004 without handwritten signatures making them enforceable and acknowledged them as writs of execution in enforcement scenarios.

4. Conclusion: A forward-looking perspective in digital-only banking

In conclusion, the Romanian legislature has taken significant steps to regulate digital-only banking through various legislative measures. While GO 85/2004, which governs the remote conclusion of contracts, laid the foundation for remote transactions in the financial sector, the implementation of PSD2 in Romania and the more recent introduction of the ADR Norm for remote customer identification have further improved the efficiency and accessibility of remote customer onboarding for banks.

Looking forward, the implementation of the third payment services directive and payment services regulation will likely encourage the development of open banking and banking as a service platform. These platforms will integrate fintech companies and banks within the same IT solution and will strengthen the cooperation between them in their common goal of providing digital-only financial services to customers through a comprehensive range of financial products that cater to evolving customer needs.

Serbia

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Serbia

PPAs in Serbia – financing renewables under a new legislative framework

The financing of renewable energy projects in Serbia has traditionally relied on government support as part of national energy transition strategies in the form of feed-in tariffs. Following the successful completion of pioneering wind farm projects and significant regulatory changes from 2021 to 2023, feed-in based subsidies are largely cut-off (except for small-scale wind and solar projects as well as demonstration projects). As a result, we see a shift towards market-based incentives, including market premiums. The global energy crisis, coupled with unprecedented breakdowns in the coal facilities of the Serbian public offtaker Electric Power Company of Serbia (***EPS***) from December 2021, made clear that the market must take a proactive approach to tap into alternative means of electricity supply.

One of these is a commercial power purchase agreement (***PPA***) which is recognised for the first time in the law on the use of renewable energy sources (***RES***) adopted in 2021 and recently amended in 2023. Banks which were traditionally financing RES projects backed by the subsidy-based PPAs are now facing a new environment where energy producers base their electricity sales on commercial PPAs with wholesale traders. This requires dealing with certain new risks, in particular the electricity market price risk but also the creditworthiness of the offtaker.

In the following, we look at key points worth considering in this context and the impact of the regulatory requirements.

1. Pioneering financings based on commercial PPAs

The first project financing based on a commercial PPA in Serbia successfully closed in 2022. It related to the Krivača windfarm developed by the MK Group and the Slovenian ALFI Green Energy Fund and consisted of a 155 million euro financing arranged by Erste Group Bank. Swiss electricity producer and trader Axpo acted as offtaker in a 10-year PPA structure which involved both physical and virtual (financial) PPAs. This pioneering transaction was a major milestone and confirmed banks' readiness to finance commercial PPA based RES projects.

Meanwhile new financial PPAs have been announced, with ISDA Master Agreements signed between Fintel Energija and Danske Commodities A/S for hedging purposes. The agreements relate to four wind farms which are currently under construction.

2. Challenges with structuring commercial PPAs

Compared to the feed-in based financings, project financing based on commercial PPAs gives parties greater flexibility to tailor the terms to the needs of the project, but also requires greater involvement of the parties in tackling its complexities. In our experience, the most complex part of the transaction is the structuring of the long-term PPA. The main challenges comprise: (a) market-based bankability issues arising out of the novelty of the commercial PPA concept; and (b) a complex regulatory framework.

(a) Market insight

One of the main concerns from the lenders' and producers' perspective is the creditworthiness of the offtaker. As commercial PPAs are at the initial stages of implementation in Serbia and there is no track record of offtakers with the appetite to participate in PPAs, the purchasers and the banks are relying on standard mitigants comprising the investment grade credit rating of the offtaker and a comprehensive collateral package. The security package usually includes letters of credit and guarantees of a parent company with adequate credit rating, which may be coupled with security over certain developers' assets. Detailed foreign exchange rules in Serbia do not expressly regulate credit support instruments for cross-border financial derivatives, but the structures have so far been implemented by applying relevant rules by analogy.

Further, predictability of the revenue streams is ensured by the electricity price hedging, having in mind that a physical sale (either to the offtaker or on the regulated market) is based on market (floating) prices. Given the long-term nature of financial PPAs, reference (floating) prices need to be from one of the developed markets. Currently, the Hungarian Power Exchange price is used in the region for this purpose. This creates a difference in the benchmark used in financial PPAs and the floating price under which electricity is physically sold, which is normally a price from the local electricity market, i.e., SEEPEX for Serbia. Regardless, this difference is not seen to present an issue in the highly correlated markets where absolute spreads are minimal, as it still arguably meets the hedging purpose which must be met to satisfy foreign exchange rules. Another mechanism is the sale of electricity at auctions where a market premium is awarded based on the maximum offered price for electricity per MWh determined by the government, with the first auctions for wind and solar launched in June 2023.

(b) Regulatory insight

Commercial PPA structures may vary, with standardised agreements such as the ISDA Master Agreement for financial PPAs and the EFET General Agreement for physical PPAs being used most frequently. Financial PPAs are typically entered into as a swap or contract for difference. They are considered a derivative financial instrument, which is subject to certain regulatory rules, primarily in the capital market (securities) and foreign exchange areas.

In Serbia, financially settled commodity derivatives fall under the definition of "financial instruments" transposed in the Capital Market Law from MiFID II. However, "non-standardised" derivative financial instruments are excluded from the scope of the law, which is understood in practice to refer to privately negotiated (***OTC***) derivatives, such as ISDA Master Agreement based bilateral transactions entered into outside of a regulated trading venue. As such, capital market rules do not pose issues for implementation of the financial PPA arrangements.

On the other hand, Serbia has detailed foreign exchange rules on transactions with financial derivatives which capture OTC derivatives such as financial PPAs. The rules apply to cross-border transactions, with an exclusion for local transactions which are expressed in local currency. These forex rules are focal due to their mandatory nature and impose the following main requirements:

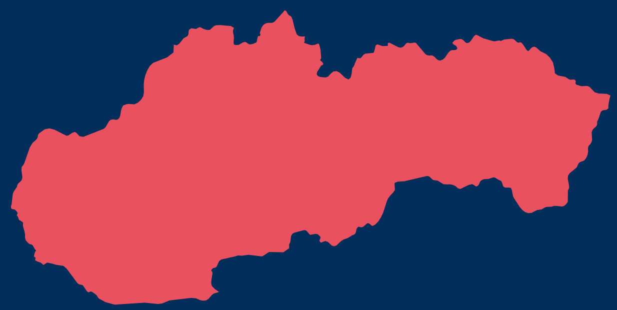
- *Standard terms* — the transaction has to be concluded as a "*standardised framework agreement for financial derivatives which is customary in business practice*". So far ISDA Master Agreements have been used in practice, while bespoke (i.e. privately drafted) PPA agreements are not yet sufficiently tested. Since local practice is still developing, customary character relies on international, primarily EU, practice;
- *Hedging purpose* — the producer can enter into financial PPAs only for hedging purposes and up to the amount of its actual underlying exposure to electricity price fluctuations. Speculative derivatives are not allowed. Consequently, over-hedging is also not allowed, although it is not expected to occur given that usually financial PPAs do not relate to the entire expected production but only a certain percentage thereof (e.g., 65 per cent. or 70 per cent.);
- *Local currency and onshore account* — payments have to be made in foreign currency and not Serbian Dinar and the producer has to use its onshore bank account; and
- *Set-off/netting* — set-off/netting is allowed only for the mutual claims/debts under financial derivatives and in accordance with the standardised framework agreement customary in business practice. Thus, set-off/netting may be performed only for mutual claims under financial PPAs and not with other types of claims/debts, especially not with the physical PPA .

Although foreign exchange rules are restrictive, especially when it comes to set-off between financial and physical PPAs, the transactions implemented so far have shown that the requirements thereunder can be met in a commercially acceptable manner.

3. Outlook

Banks are steadily adapting to financing of RES projects on the basis of commercial PPAs. The development of corporate PPAs is expected as the next step.

Worldwide, by the end of the third quarter of 2022, corporate PPAs were concluded for 33GW of renewable energy power plants, which represents an increase of 7 per cent. compared to the whole of 2021. Serbia is expected to follow this trend, with corporate PPAs playing an important role in the process of transition toward climate neutrality. Although corporate PPAs represent a higher risk from a financing perspective, the banks most often involved in financing renewable projects consider such project still bankable if certain conditions are met, including adequate credit standing of the buyer and coverage of a significant portion of the production (e.g., 70 per cent.) with the PPA for the majority of the term of the loan.



Slovakia

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AML regulatory framework – is Slovakia on the right path?

Are Slovak financial institutions that provide banking products via remote customer onboarding already able to handle the heightened risk of money laundering and terrorist financing? Have Slovak supervisory authorities already implemented efficient regulatory framework for fighting all anti-money laundering (***AML***) and counter-terrorist financing (***CTF***) risks during remote onboarding?

In this article, we delve into a critical examination and comparative analysis of Slovakia's approach to remote onboarding in comparison to EU authorities. Our aim is to shed light on the missing elements within the Slovak regulatory framework that should align with EU standards.

1. Regulation of remote customer onboarding: is Slovakia already prepared or just preparing?

(a) EU approach

In September 2020, the European Commission (the ***Commission***) released its Digital Finance Strategy for the European Union (***EU***). As part of this strategy, the Commission requested the European Banking Authority (the ***EBA***) to develop guidelines on applying AML and CTF rules in the context of remote customer onboarding. Following the Commission's request, the EBA published guidelines on the use of Remote Customer Onboarding Solutions (the ***Guidelines***) in November 2022. The Guidelines apply to credit and financial institutions falling under the Anti-Money Laundering Directive (the ***Financial Institutions***) and competent national authorities within EU member states. The National Bank of Slovakia (the ***NBS***), as the regulatory authority in Slovakia, has already notified the EBA of its intention to comply with the Guidelines. The Guidelines establish common EU standards for developing and implementing sound, risk-sensitive initial customer due diligence processes in remote customer onboarding. The Guidelines align with the tools and processes already utilised by many Financial Institutions. However, some countries may require specific regulatory changes to comply fully. Slovakia is one of such countries where further regulatory developments are especially anticipated.

(b) Slovak legislative approach

Slovak Financial Institutions have cautiously adopted remote customer onboarding, with one commercial bank pioneering the use of biometric applications in 2018. However, at that time, there were no specific legislative requirements in place. The NBS attempted to regulate remote customer onboarding procedures but issued only general regulations on this matter in an opinion in December 2018 (the ***NBS Opinion***). Further, the Slovak Financial Intelligence Unit (the ***FIU***), as the controlling body of obliged persons under the AML regulation, issued an opinion aligning itself with the NBS Opinion in 2019 (the ***FIU Opinion***). However, as explicitly stated therein, the FIU Opinion was and is still not legally binding and expresses the opinion of the FIU only and not also of financial regulatory authorities or courts. Additionally, both opinions do not provide any details on procedures which Financial Institutions need to have in place. In practice, local Financial Institutions then implemented processes leveraging knowledge from parent companies operating in jurisdictions with more comprehensive regulations.

Slovakia is now home to over 30 commercial banks. Approximately half of them offer applications and websites which allow customers to open bank accounts or make use of other banking products. Of these banks, only a fraction allow new clients to complete the onboarding process without visiting a physical establishment. Some of these banks utilise third-party couriers to verify new clients' identities, while others encourage customers to visit any of their branches to receive a payment card, effectively transitioning from non-physical to physical onboarding. A small number of said banks (approximately three to five) utilise telephone or web applications with biometrics, live video calls, selfie or video capturing, anti-spoofing, video-based ID security checks and collaboration with state authorities to validate ID documents. These measures are implemented for identity verification, document authenticity verification and security checks.

The NBS Opinion as well as the FIU Opinion are still in force. There have been no amendments or detailed changes to the opinions despite the actual technological developments within the IT sector. Furthermore, the NBS Opinion is limited to elementary recommendations, but at least it does not narrow down the ways of conducting client due diligence to one enhanced form only.

Through an interpretation of the Slovak AML legislation, which is questionable from our perspective, the FIU Opinion concluded that remote onboarding always represents a higher risk of money laundering and financing of terrorism. Therefore, it would automatically trigger the obligation to perform enhanced customer due diligence. The FIU came to this conclusion despite the fact that it explicitly mentioned that the given procedure may represent an obstacle to the use of new technologies.

The NBS Opinion provides a high-level view of the technologies used for remote onboarding, offering only brief and general recommendations across various aspects related to remote onboarding, such as services suitability, client risk assessment, technical supplier evaluation and employee training. In the same way, the FIU Opinion does not address in necessary detail of how the customer identity confirmation, document authenticity and integrity checks or verification process should be ensured. It is not at all as detailed as the Guidelines. The FIU Opinion only stipulates that when applying the exception from face-to-face identification verification, it is necessary to fulfil other measures such as (i) requesting a written confirmation from another EU bank that contains the customer's identification data or (ii) ensuring that the first payment is made through another EU bank account held in the name of the customer and submitting a document proving the existence of such account. Regarding the security of technology, the NBS Opinion only mentions system requirements in general, without details about encryption, key validation, message signing and so forth. On the other hand, the Guidelines determine when the criteria for means of customer identification verification are deemed to be met, with reference in particular to the EU eIDAS Regulation and to "substantial" or "high" security levels.

The NBS Opinion does not in any way address reliance on third parties and outsourcing in respect of activities related to the remote onboarding. In contrast, the FIU Opinion for the so-called assumed customer identification stipulates that the Financial Institutions may take over the customer's identification data already acquired by another entity. However, even in a separate opinion dedicated to this topic the FIU refrains from establishing the conditions outlined in the Guidelines, particularly concerning (i) the steps required to ascertain the adequacy and alignment of third-party remote customer onboarding procedures and the data collected and (ii) the procedure ensuring the continuity of the business relationship established between the customer and the Financial Institution to guard against issues arising from deficiencies in the remote customer onboarding process carried out by third parties.

2. So, is Slovakia already prepared or just preparing?

The work on the harmonisation of the Guidelines therefore awaits the NBS as well as the FIU, as the Guidelines are far from automatically assuming such a strict approach to the implementation of additional due diligence measures without further consideration of the circumstances. The NBS and the FIU should at least update their above-mentioned opinions with the aim of achieving clear, legally binding and enforceable regulations corresponding to the latest technical knowledge. However, perhaps a more appreciated approach would be to issue newly adjusted and tailor-made legislation superseding the previous one and certainly in the form of a regulation with higher legal force.

The Financial Institutions in Slovakia, on the other hand, still face significant challenges in adapting their internal policies and procedures, relying on third parties, managing IT and security risks as well as ensuring compliance with trust services. Overcoming these challenges is essential in order to achieve compliance with the Guidelines. Quite understandably, they are still awaiting the legislative implementation of the Guidelines, which is in the hands of the regulatory authorities. Unfortunately, to date there has been no visible progress yet in this regard.

Slovenia

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Slovenia

Proposed amendments in Slovenian insolvency legislation: paving the way for new restructuring tools

In 2019, Directive (EU) 2019/1023 (the ***Directive***) was published which, among other things, requires Member States to implement certain solutions to facilitate the restructuring of companies that are at risk of insolvency. Slovenia is relatively well prepared for the Directive, as most of the solutions introduced by the Directive have already been incorporated into the Slovenian Financial Operations, Insolvency Proceedings, and Compulsory Dissolution Act (the ***Insolvency Act***). However, insolvency law reform is nevertheless necessary. In this article, we describe a proposal for an amendment of the Insolvency Act which is currently on the negotiation table of Slovenian legislators as well as its potential impact for debtors and creditors if adopted.

1. Overview of the amendment of the Insolvency Act

On 20 April 2023, the Government of the Republic of Slovenia proposed an amendment to the Insolvency Act (the ***Amendment***), which as of August 2023 awaits the second reading in the National Assembly. The Amendment introduces a number of changes and novelties to the regulation of insolvency proceedings in Slovenia. It further aligns the Insolvency Act with the Directive and eliminates the identified inconsistencies of the current law with the Constitution of the Republic of Slovenia, while some solutions are also based on previous experience from practice.

Both the rules governing the obligations of the management upon the occurrence of insolvency and the rules governing compulsory settlement and bankruptcy proceedings will be amended and supplemented. The proposed changes are supposed to contribute to a better positioning and repayment of creditors in insolvency proceedings and provide for several incentives and obligations for the management, with the aim of ensuring that such proceedings are opened in a timely manner.

2. Court restructuring procedure due to risk of insolvency

The Amendment provides for a new procedure in the event a debtor is facing the risk of insolvency, i.e. when it is likely that the debtor will become insolvent within a period of one year.

The current Insolvency Act already provides for an out-of-court preventive restructuring procedure for companies at risk of becoming insolvent, which is designed for the restructuring of financial receivables of small, medium and large companies and therefore requires less court intervention and supervision.

This procedure will remain the same, however the Amendment introduces a new procedure intended for all companies and sole proprietors that are at risk of insolvency, as well as for the restructuring of all receivables, both financial and commercial, where an out-of-court restructuring could not be achieved for lack of consent of all creditors.

This so-called court restructuring procedure follows the model of compulsory settlement procedure, which is applicable where the debtor has already become insolvent, with some specific features. The key differences to a compulsory settlement are as follows:

- Only debtors can initiate the court restructuring procedure.
- The procedure also cannot be initiated if the debtor has not complied with certain tax or annual reporting obligations.
- If the court restructuring procedure is unsuccessful, the bankruptcy proceedings would not be initiated automatically.
- There is no possibility of a debt-to-equity swap.

The purpose of the new procedure is to stimulate debtors under threat of insolvency to resort to out-of-court restructuring as soon as possible if the business has any prospect of success. The possibility of initiating a court restructuring procedure is also supposed to encourage creditors to enter into such restructuring because if they object thereto, the consequences of initiating a court restructuring procedure, including the suspension of enforcement proceedings and the possibility of being overridden, would be triggered.

3. Obligations of the management upon the insolvency or risk of insolvency

The Amendment emphasises timely action to prevent insolvency more effectively. Hence, certain obligations are pre-emptively imposed on the management of a company at the stage where there is a risk of insolvency, rather than after insolvency has occurred.

The management and other bodies of a company should keep under constant review developments that could jeopardise the continued existence of the company. It is expressly provided that if a company is threatened with insolvency, the management and other bodies of the company should: i) avoid any conduct which would result in an unequal treatment of creditors who are in the same position vis-à-vis the company, ii) take into account the interests of creditors, equity holders and other stakeholders in their decisions, and iii) avoid any conduct that jeopardises or diminishes the assets of the company or otherwise endangers the company.

Upon the insolvency of a company, the management is required to initiate insolvency proceedings within one month of the occurred insolvency. This is different to the current regime under which the management was obliged to submit a report on the financial restructuring measures. Failure to comply with this obligation will expose the management to fines and, in the event of damage to creditors, to liability for damages and even criminal liability.

These redefined management obligations and liability are supposed to encourage a more responsible approach by the management to resolve company's financial difficulties in time or to arrange for its timely and orderly winding-up, resulting in better repayment of creditors.

4. Compulsory settlement for small businesses

According to case-law, in cases where the simplified compulsory settlement procedure may have been applicable, companies had shown a net turnover of less than EUR 700,000 or value of assets of less than EUR 350,000, while at the same time their liabilities exceeded to a large extent both the amount of the turnover and assets. Such companies would no longer be able to continue their business activities after the implementation of the simplified compulsory settlement, which is a departure from the primary purpose of this legislation.

Therefore, in addition to the change of title of the procedure from simplified compulsory settlement to compulsory settlement for small businesses, which no longer addresses simplification but rather the subjects to which the procedure is applicable, the Amendment introduces an additional restriction. The procedure will continue to be reserved for micro companies and sole proprietors who meet the criteria set out in the Slovenian Companies Act, however, the value of their assets over the last two years and the amount of their total liabilities must not exceed EUR 700,000 respectively.

An additional simplification of the procedure is the new exemption from the need to submit an auditor's report, which is a report from a certified business valuator on the value of the business and the estimated value of the assets. However, the procedure will now involve the appointment of an administrator to supervise the debtor's business and verify the existence of the claims lodged, which will further protect the position of creditors.

The proposed changes take into account that compulsory settlement for small businesses is applicable to the smallest economic entities and sole proprietors and should therefore not impose excessive costs and administrative burden on them, which could consequently prevent them from restructuring. At the same time, the changes are supposed to prevent debtors from abusing this institute in cases where the liabilities are too high for the restructuring to be successful.

5. Changes to the ordinary compulsory settlement

Under the Amendment, in addition to the compulsory settlement for small businesses, micro companies will also be able to enter into an ordinary compulsory settlement procedure. The same will apply to sole proprietors.

The Amendment is also extending the type of creditors who may initiate a compulsory settlement procedure to creditors of commercial receivables. However, due to the additional risks associated with extending such possibility to creditors which are not financial institutions, an application by such creditor will not lead to the procedure being instituted directly. Instead, it will first be served on the debtor who will have the opportunity to oppose such commencement of the compulsory settlement procedure.

6. Repayment of creditors and greater transparency in bankruptcy proceedings

The repayment of creditors in bankruptcy proceedings which have already commenced can be improved by: i) solutions which allow the assets subject to sale to be made known to the widest possible range of potential buyers, ii) sale procedures which allow for the highest price to be obtained and prevents the debtor or other potential buyers from hindering the sale or influencing the price of assets subject to the sale, and iii) keeping the costs of the sale and other costs of the bankruptcy proceedings as low as possible.

If the subject of the insolvency is a going concern, one of the options already provided is the sale of the debtor's business as a whole. However, under the current regime, such a sale can only be carried out at the proposal of the administrator and with the consent of the creditors. The Amendment brings changes in such a way that creditors play a stronger role in this regard and may request the administrator to prepare all necessary arrangements for the sale of the debtor's business as a whole.

A proposed solution aimed at making sales in bankruptcy proceedings known to the widest possible range of potential buyers is connecting and publishing sales in bankruptcy proceedings on a single sales portal. Such publication is currently optional for administrators but will be compulsory under the proposed changes. This is supposed to allow for greater transparency of the bankruptcy proceedings.

The Amendment also introduces the possibility of selling assets through online public auction which is supposed to widen the pool of potential buyers and make bargaining impossible, resulting in higher prices.

7. Appeal on points of law in insolvency proceedings

Under the current rules, it is not possible in insolvency proceedings to lodge an appeal on points of law. However, court decisions in insolvency proceedings can have far-reaching consequences. For example, granting a remission of liabilities may be the only way for over-indebted insolvent debtors to relieve themselves of the burden of debt and its existential threat, giving them a realistic chance and an economic basis for rebuilding their existence. On the other hand, consequences of the remission of liabilities also fall within the sphere of creditors, who lose their right to enforce payment of receivables on which the remission has effect, constituting a departure from the fundamental principle that obligations must be fulfilled.

The Amendment provides that an appeal on points of law will be possible, but only against final second-instance decisions: i) rejecting an application to initiate proceedings, ii) terminating bankruptcy proceedings without distribution, or iii) granting an objection to the remission of liabilities or rejecting an application for the remission of liabilities. Such court decisions, which would have far-reaching consequences for the parties to the proceedings, may require uniformity in the application or may be important for the development of the law through case-law.

8. Conclusion

It is impossible to predict in what form the Amendment will eventually be adopted. Changes may be made to it in the course of the legislative process. What is certain is that the Amendment brings new tools for companies to be able to avoid insolvency and for better organised and efficient insolvency proceedings if insolvency occurs. However, it remains to be seen how the Amendment will influence the balance between ensuring the continued operations of debtors and protecting the interests of creditors in practice.

Türkiye

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Paksoy

Türkiye

Regulatory transformation and the future of financial services in Türkiye

Companies within the private sector have turned their faces towards digitalisation of financial services in the Republic of Türkiye especially with the effect of legislative amendments made since 2019. Transformation of technology and innovative business models of fintech companies obliged Turkish lawmakers to re-create the legislative foundation in order to attract and increase investments. According to the Türkiye Fintech Guide published in 2023, in 2022 $90 million were invested in fintech companies and the survival rate of that investment is 94.92%. Under the current Turkish law ecosystem, payments and securities settlement systems, electronic money and payments services, digital banking, open banking, "Banking as a Service", and insurance technologies are fintech tools available in the market. This article focuses on the latest developments regarding payment services and the digitalisation of the banking sector.

1. New area of payment services following legislative amendments made in 2019

The main piece of legislation regulating payment services in Türkiye is the Law on Payment and Securities Settlement Systems, Payment Services and Electronic Money Institutions (the ***Law***). It was published in 2013 in line with the Payment Services Directive 1 in Europe, i.e. PSD1. To meet the needs of sector players and to make available new type of payment services in Türkiye as set forth under the Payment Services Directive 2 (***PSD2***), the Law was amended on 22 November 2019. Accordingly:

- payment initiation services and account information services have been included in the scope of payment services. Thus, an important step was taken to regulate open-banking activities in Türkiye;
- the supervisory and regulatory powers of the Banking Regulation and Supervision Agency (the ***BRSA***) over payment service providers and electronic money institutions are transferred to the Central Bank of the Republic of Türkiye (the ***CBT***) to consolidate the regulatory authorities within the same institution. The CBT is now authorised to determine the nature, maximum level and rate of the fees and commissions to be paid for the provision of payment services; and
- a professional organisation with public institution status, i.e., the Union of Payment and Electronic Money Institutions of Türkiye (the ***Union***), was provided for, of which payment and electronic money institutions have to become a member within one month of obtaining their licence. The Union was established in 2020 and it plays a significant role in the determination of professional standards and strategies of the Turkish payment sector.

Apart from the above, certain other amendments, such as procedures for operating permissions and criteria for payment institutions, were standardised through laws, regulations and communiqués in Türkiye in parallel with PSD2.

Following those amendments dated 2019, the CBT published new secondary legislation on 1 December 2021, namely the Regulation on Payment Services and Electronic Money Issuance and Payment Service Providers (the ***New Payment Regulation***) and Communiqué on Information Systems of Payment and Electronic Money Institutions and Data Sharing Services in the Field of Payment Services. Among all other new rules or changes, the rule on activities of foreign payment institutions was the most striking change for international market players which are seeking a way to provide their services to Turkish residents without obtaining any license or approval.

Before the amendments summarised above, there were no provisions regulating cross border money transactions and it was generally accepted in the market that there was no licensing requirement for foreign institutions in case the settlement accounts were outside Türkiye. However, the New Payment Regulation explicitly allows Turkish payment institutions to cooperate with foreign licensed entities for cross-border payment transactions, provided that a cooperation agreement is executed with a local institution and the authorisation of the CBT is obtained by the respective foreign payment service provider. Such foreign institutions are not the visible face of the services to the customers in Türkiye. An authorisation is different from a domestic payment service license because it does not require a foreign entity to be incorporated in Türkiye, the set of documents for the filing is much lighter and the ongoing regulatory requirements are not as burdensome as for the domestic payment service license. In light of this regulatory development, the approach by the CBT and its interpretation of cross-border money transfers of Turkish residents through foreign institutions without the authorisation cannot be confirmed before the CBT issues a specific guidance or a decision thereon.

2. Digitalisation of banking activities

The Turkish banking system is the most crucial pillar of the financial services and in parallel with the developments in the payment services area, the banking sector has also started to be digitalised. According to the data in the Türkiye Fintech Guide 2023, there are 90.6 million active digital banking users and Türkiye is 9th in credit card transactions worldwide. In order to bring banking services into a new era, at the end of 2021, a Regulation on Operation Principles of Digital Banks and Service Model Banking (the ***Banking Regulation***) was published to pave the way for digital banking in Türkiye and to set forth the main principles regarding "digital banks" and "Banking as a Service".

The first digital bank of Türkiye was established in 2022, i.e. Hayat Finans Katılım. This happened four years following the establishment of the first European digital bank in 2018 in Germany. Banks in Türkiye may start to operate after they obtain the operation license. As of July 2023, among the five digital banks that obtained establishment permission, T.O.M. Katılım Bankası and Hayat Finans Katılım Bankası are the only ones which hold the operation license and both of them are participation (*Islamic*) banks.

(a) Digital bank principles

Digital banking products and services include lending, all kinds of money transfers and investments made through internet banking and mobile applications, invoice and credit card transactions, virtual POS machines, and transactions with QR codes. Although there are certain additional requirements under the Banking Regulation, they are subject to the same legislative requirements as all credit institutions.

The Banking Regulation authorises the establishment of digital banks which may operate as deposit banks or participation (Islamic) banks . Some of the main principles provided under the Regulation are as follows:

- Digital banks are not entitled to open physical branches or any kind of representative office. They may provide services to their customers through ATMs and they are required to establish an office for customer complaints.
- Digital banks are not permitted to provide safety deposit services other than those which may be carried out digitally.
- The capital of the digital banks must be a minimum of TRY 1 billion.

The activities of digital banks whose capital is below TRY 2.5 billion are restricted. For instance, their credit customers are limited to financial consumers and SMEs and these digital banks are not permitted to provide foreign currency loans to SMEs. However, the BRSA may disapply those restrictions to those digital banks whose capital exceeds the TRY 2.5 billion threshold.

As of July 2023, only one of the digital banks holding an establishment permit, Ziraat Dinamik Banka, has a capital exceeding TRY 2.5 billion, and is therefore permitted to provide all unrestricted banking activities in the Turkish market. The remaining digital banks that obtained the establishment permit did so on the basis of a capital of TRY 1.5 billion.

(b) Banking as a Service

Banking as a Service is now regulated under the Banking Regulation so as to increase financial inclusion and facilitate access to banking services, and it is considered as a tool for banks to broaden their customer base.

This is a banking model allowing some of the banking services to be provided through non-banking companies established in Türkiye to their customers based on their back-to-back arrangement with Turkish banks. Those Turkish banks are described as service banks which provide service model banking services through interface providers for the services within the scope of their license. The services are reflected in the bank's financial statements and interface providers may not create the impression of being licensed banks or payment service providers. Banks are not required to obtain additional authorisations from the BRSA to act as service banks or to broaden their licenses.

Banks are not allowed to provide interface services. Interface service providers should obtain the permission of the BRSA to act as such support services and they may only cooperate with more than one bank if that is approved by the BRSA. Furthermore, as those third party service providers should be established in Türkiye, banks are not allowed to cooperate with foreign entities. The scope of the agreement to be concluded with banks and interface providers is determined under the Banking Regulation, and it should refer to certain principles such as the scope of the services and responsibilities of service banks.

This new system attracts the attention of retail sector companies, especially big online market places and chain supermarkets, as they have a large number of customers and invest in the digitalisation of their services. Thus by offering banking services, particularly customer credits, on their own website, they would be able to integrate all shopping tools within one website and facilitate the payment mechanics.

3. Conclusion

Technological developments in the financial sector impact the fintech area in Türkiye. With the contribution of government policies and support, the legal framework is being developed to follow new technologies, needs of players and international practices. To that end, changes in PSD2 were reflected in the Turkish payment services legislation, open banking activities are recognised and digital banks are permitted. Additionally, so that new innovative financial products can be easily accessible, Banking as a Service has been permitted.

In spite of all these efforts, there are still certain grey areas under Turkish law, especially in relation to international money transfer structures, use of foreign service providers by Turkish residents and treatment of cryptocurrencies, as they are neither considered electronic money nor specifically regulated under these new regulations. Therefore, new pieces of legislation are yet to come!

Ukraine

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Ukraine

Ukraine's regulatory reshaping: safeguarding stability amidst geopolitical challenges and paving the path for post-war recovery

Ukraine's regulatory landscape witnessed significant shifts last year in response to the pressing need to safeguard against capital outflows and keep the overall Ukrainian economy afloat in the face of geopolitical challenges. With the Russian invasion at the beginning of 2022, the adoption of new regulations aimed at curbing capital flight has taken centre stage. At the same time, while the conflict disrupted the usual pace of legislative changes, the groundwork for significant regulatory transformations had been laid prior to the war. In this article, we delve into the dynamic interplay between ongoing reforms, the impact of the conflict and the regulatory measures implemented to safeguard financial stability. By exploring key aspects such as financial services, payment services, capital markets and virtual assets laws, we examine how Ukraine navigates the delicate balance between reform and stability amidst geopolitical turmoil.

1. Restrictive measures and their impact

Following the Russian invasion of Ukraine in February 2022, martial law was declared across the entire territory of Ukraine, leading to the implementation of currency control restrictions by the National Bank of Ukraine (the ***National Bank***). These restrictions included, among others, the suspension of the foreign currency market, limited cash withdrawals and a moratorium on cross-border foreign currency payments.

The imposition of a temporary moratorium on cross-border payments from Ukraine to abroad has significantly affected the banking, finance and capital markets sectors. This has led to practical challenges and limitations for individuals, businesses and financial institutions operating in Ukraine. However, as the military conflict evolves, the National Bank has been gradually introducing exemptions to the moratorium, which provide some flexibility and facilitate specific types of transactions. These exemptions include the following in particular:

- *International financial institutions (IFIs)*: transactions conducted by IFIs and transfers of funds by Ukrainian residents to IFIs under loan agreements;
- *Transactions of Ukrainian banks*: banks' operations, including payments under letters of credit, guarantees and counter-guarantees provided by Ukrainian banks prior to the beginning of the Russian invasion;
- *Imports of goods*: payments under export-import contracts related to the purchase by Ukrainian residents of goods and certain categories of services;
- *State-guaranteed instruments*: payments under instruments secured with state guarantees; and
- *Authorised payments*: payments authorised under a separate permit issued by the National Bank.

The most recent exemptions which were introduced in June 2023 further expanded the scope of permitted cross-border operations. These exemptions now allow the repayment of loans backed by IFIs, export credit agencies (ECAs), development finance institutions (DFIs) and new loans granted by foreign lenders after 20 June 2023 and disbursed to Ukrainian borrowers' bank accounts opened with Ukrainian banks. Despite these exemptions, the restrictions still present challenges for currency exchange, trade financing, loan repayments and international investments.

Market participants, including businesses, investors and financial institutions, must navigate these limitations and ensure compliance with the established exemptions to maintain smooth financial operations. The National Bank's resolution on the functioning of the banking system during martial law, originally a concise one-page document designed for an immediate response, has now evolved into a comprehensive framework and remains a pivotal piece of regulation in these unprecedented times. Its continued significance underscores the importance of safeguarding the reliable and stable operation of Ukraine's financial system and of ensuring the smooth functioning of critical infrastructure.

2. Looking ahead: gradual implementation of other major pieces of regulation

Beside the restrictive measures referred to above, several major pieces of regulation have been recently introduced or are in the process of implementation, covering various aspects of the financial industry. These include financial services regulation, payment services law, capital markets law and virtual assets law. These regulatory reforms are expected to modernise the financial sector, attract investments, and establish a robust framework for conducting financial activities in Ukraine. While some laws have already come into force, further secondary regulations are still being developed to shape the finer details of their provisions and ensure their effective implementation.

(a) Financial services regulation

The adoption of the so-called "split law" back in 2019 brought about a significant transformation in financial services regulation. This law resulted in the dissolution of the then effective regulator of financial services markets in Ukraine and the distribution of its responsibilities between the National Bank and the National Securities and Stock Market Commission (the ***Securities Commission***). Since the middle of 2020, the National Bank has taken on the role of regulating the non-bank financial services market in Ukraine, encompassing various institutions such as insurance companies, leasing companies, factoring companies, credit unions and pawnshops.

Despite the ongoing military conflict, the National Bank has been actively working on secondary regulations to ensure equal access to financial services, safeguard client rights, promote market transparency and uphold openness. These efforts include the preparation for implementing new laws on insurance and financial leasing, as well as the development of new concept for factoring regulations in line with international standards. By continuing to refine the secondary legislation, the National Bank aims to fully implement the financial services law, providing enhanced clarity and protection for participants in Ukraine's financial markets.

(b) Payment services law

The payment services law, effective from August 2022, introduced a new legal framework for payment services in Ukraine. It includes clear classification of payment services, differentiated authorisation procedures for providers, accreditation of international payment institutions and the introduction of a new electronic money regime. Open banking principles are also introduced, enabling client account access and financial information sharing with other payment service providers subject to the client's consent. Additionally, the law establishes a regulatory sandbox for testing innovative solutions in the financial sector. These developments aim to modernise and regulate Ukraine's payment services sector, promoting innovation and consumer protection.

Since the majority of the law's provisions came into effect last year, the National Bank has considerably updated and adopted several new regulations for the market participants, including the one detailing the accreditation procedure for branches of foreign payment institutions operating in Ukraine. The implementation of the open banking regime is set for 2025, allowing time for preparation and standardisation of open application programming interfaces (APIs) and internal process adaptations. This transformative move is expected to stimulate fintech growth and foster the development of advanced payment products and solutions.

(c) Capital markets law

The capital markets law implements key provisions of European Union capital markets legislation and introduces significant changes to Ukraine's financial sector as well. The law, inspired by MiFID II, MiFIR and CRD IV, aims to liberalise investment attraction and introduce new financial instruments. It establishes three models of organised markets, providing access to capital markets for large, medium-sized, and small businesses. This significant piece of legislation also regulates derivative financial instruments, introduces certificates of bank deposits as an alternative to traditional deposits and modernises financial intermediaries by expanding their range of services.

The above changes are expected to promote the efficient functioning of Ukraine's capital markets, increase access to investment opportunities and attract domestic and foreign investments into the country's economy. While the law became effective in 2021, further secondary regulations are still being developed to shape the specifics of its provisions.

(d) Virtual assets law

The virtual assets law adopted in February 2022 establishes a regulatory framework for the virtual assets (***VA***) sector in Ukraine. The law recognises VA as a form of property rights and claims but prohibits their use as a means of payment in Ukraine or exchange for goods or services. It provides legal protection for VA, with ownership being certified by a virtual key. The document also regulates the activities of VA professional market participants, specifying the types of transactions they can carry out, such as the exchange and transfer of VA. Service providers in the VA sector must obtain licenses as financial institutions with a special permit for VA-related business.

The National Bank and the Securities Commission are designated as regulators for the VA sector, with detailed transaction procedures to be later introduced by these authorities. The full implementation of the virtual assets law depends on the adoption of tax rules regarding VA transactions, which is still pending. At the same time, Ukraine is working on a new version of the virtual assets law (that could replace that referred to above), which aims to align its legislation with European standards, specifically the newly introduced MiCA regulation.

3. Key takeaways

Over the last year, Ukraine has undergone significant regulatory transformations in response to geopolitical challenges and the imperative of ensuring financial stability. Currency control restrictions imposed after the Russian invasion have presented practical challenges, but exemptions introduced by the National Bank have provided some limited flexibility.

The country's focus on the gradual implementation of major legislation aims to modernise and regulate the financial industry. Efforts to refine secondary regulations for financial services, payment services, capital markets, and virtual assets will ensure equal access, market transparency and client protection. These comprehensive reforms are expected to attract investments, improve capital market efficiency and establish a resilient financial framework, which, in turn, will create additional opportunities for international partners to contribute to the recovery of the Ukrainian economy.

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