Summer 2021

IFLR

The digital arms race

As the world sprints towards CBDCs
the key hurdles begin to come into view

Americas Awards

Africa Market Makers

Decentralised Finance

Asia Fintech Special

CONTENTS

Regulars

Cover story

Corporate

Banking and finance

Special focus

Capital markets

Features

IFLR

Summer 2021 Vol 91

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EDITORIAL

IFLR to the moon

In March 2020, when the pandemic really began to show it's true potential, my first expectation was that the world would be out of action for a few months and would return to normalcy by June. How wrong I was. A year later, things are eventually easing up in some places, while others remain far off. In certain ways this will herald a return to how things were in 2019, while others will certainly never look the same.

In the corporate world, for instance, the pandemic brought about a seismic shift away from in person events towards virtual ones. As someone who often attends one or two events a week, this has been something of a double edged sword – on one hand I can attend events in Europe, Asia and the Americas on the same day, while on the other hand it is far harder to meet people when the lunch break consists of a salad in your living room.

At IFLR, we look forward to welcoming back in-person events. The benefit of bringing hundreds of experts together in one room to discuss a topic has been amplified over the last year, with the cancellation of certain events like the International Bar Association's annual conference really having an impact on the ability of attorneys around the world to network with like-minded peers. It is with a real hope that we expect our Middle Eastern Awards to be a live event this October in Dubai, but of course the last year has taught us that things can turn on a sixpence.

This month, the Bitcoin 2021 conference in Miami attracted more than 50,000 attendees, up from only 2000 in 2014, which certainly suggests that in the US at least, the appetite for in-person events is roaring back. The event itself heralded something of a turning point. Back in March 2020, the cryptocurrency space was in a tailspin. The price of one bitcoin was lower than $4000 at one point and the legion of alt coins were also significantly lower than the prices seen this quarter.

To celebrate the launch of our new digital finance section, this Summer Edition is loosely themed on all things crypto. On page 20, this edition's cover story from EMEA reporter Natasha Teja, we look at the race to produce and release a successful CBDC that is taking place around the world. The piece looks at central bank digital currencies in China, Europe, the US and elsewhere.

Other features include a market poll on India's proposed ban of cryptocurrency from Karry Lai on page six, and on page 38 Lewis Cohen discusses the Financial Action Task Force's draft revised guidance on the recommended risk-based approach applicable to entities engaging in activities involving virtual assets. On page eight you can read my interview with Coinbase's legal team following their April IPO on the Nasdaq.

Other features this month include our China outbound investment guide, our Asia fintech focus, and this year's Africa market makers edition, as well as all your other favourite regulars.

It's a bumper summer special. Enjoy the issue.

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International Financial Law Review is published four times a year by Euromoney Institutional Investor PLC, London.

Printed in the UK by Buxton Press, Buxton, England

International Financial Law Review 2021
ISSN 0262-6969

ONLY ONLINE

EMEA

Post-Brexit regulatory divergence is imminent

While EU and UK rules have so far remained mostly aligned, it is likely that this will change very soon and the market should stand ready. Sources suggest that settings in the financial regulation space are about to change significantly

ASIA

China's capital markets need better access and connectivity

Regulatory reform, including close-out netting, is improving international investor confidence, but more work lies ahead. While a number of initiatives have already been introduced to help attract foreign investors, better connectivity and access improvements are still needed

AMERICAS

Cryptocurrency industry welcomes regulatory clarity

As the United States inches closer to crafting cryptocurrency rules, stakeholders eager for simplicity may have to continue waiting. With Gary Gensler at the helm of the SEC, the timing has never been better for the country to act

EMEA

Africa calls for a different definition of green

The disparity in discourse and definitions of ESG between Africa and western nations has made it more difficult for the continent to mobilise climate related funds. Africa remains popular for green investment, but is at a different level of industrialisation to other locations

AMERICAS

Share buybacks return after Covid-19 pandemic pause

Companies with significant cash are renewing share buybacks on the strength of robust company earnings and economic upswing as Covid-19 uncertainty recedes. The global health crisis prompted economic downturn and forced the suspension of share buybacks in early 2020

ASIA

Virtual deal-making won't be the new norm

Following a year of uncertainty in the M&A space as a result of the Covid-19 pandemic, things are slowly returning to how they once were. Lawyers from across Asia reveal their experience and tips for doing transactions virtually and outline how things can return to normalcy

QUOTES OF THE MONTH

"DeFi platforms are generally promoted as being decentralised, although what is meant by this term in this context is open to debate"

Lewis Cohen, co-founder of DLX Law, outlines the future of decentralised finance on page 38

"Few people in the west fully understand how surveilled their financial transactions are currently, a CDBC doesn't change our level of privacy"

Caitlin Long, founder and CEO at Avanti Financial Group, discusses CBDCs on page 20

"Considering that the Indian government wants to bring down the black money mayhem by encouraging people to go for digital transactions, a complete ban on trading on cryptos will defeat the larger purpose"

Rashmi Deshpande, partner at Khaitan & Co, discusses the potential Indian crypto ban on page 6

"One stand out challenge that we confronted along the way was the rapidly shifting institutional and public appreciation for crypto as a viable and indeed an important asset class"

Paul Grewal, CLO of Coinbase, discusses their recent IPO on the Nasdaq on page 8

ASIA

Bitcoin crackdown picks up pace in China

The Chinese government has made a number of statements in the past few weeks that reiterate its stance against cryptocurrencies, especially bitcoin, indicating that strong enforcement and crackdowns lie ahead. The statements send a clear signal that the government means business by targeting areas that are causing systemic financial risks, especially while China is full steam ahead in its plan to widely circulate its central bank digital currency (CBDC), the e-RMB.

On May 21, China's State Council's Financial Stability and Development Committee, chaired by premier Liu He, vowed to crack down on bitcoin mining and trading activities to maintain financial stability and minimise financial risks. This marks the first time the highest level of the Chinese government has taken a stance on bitcoin mining.

Meanwhile the Inner Mongolia Development and Reform Commission has started its cleanup of bitcoin mining activities in the province, which have been banned since April 1. The province has been under pressure to limit its emissions, particularly around energy use from coal-fired power plants.

In their strongest statement on cryptocurrencies since 2017, the National Internet Finance Association of China, the China Banking Association and the Payment and Clearing Association of China reiterated bans that have been implemented since 2013 that bar financial and payment institutions from offering cryptocurrency services, such as registration and clearing. This time around, the ban was extended to payment and settlement. Additionally, virtual currencies cannot be used by trust and fund products as investments.

While cryptocurrency exchanges and initial coin offerings (ICOs) are banned in China, and the country does not accept them as legal lender, it is not illegal for individuals to hold cryptocurrencies. But since the first crackdown in 2013, trading has been severely limited, after the People's Bank of China prevented banks and payment companies from offering bitcoin-related services. During the ICO craze in 2017, China banned the process and made it illegal to exchange digital money unless operators are located offshore. The emphasis on offshore trading did not disappear it just moved elsewhere, including exchanges such as Binance – the largest cryptocurrency exchange in the world.

Four years later, cryptocurrency trading has become heated again in China, where investors had been piling into the bitcoin bull market before the bubble burst.

Will it take another four years for China to further crack down on cryptocurrencies? Probably not, especially when it wants to push for the wide adoption of the e-RMB. It is more likely that things will cool further when cryptocurrency ownership is outright banned.

What is clear is that there will continue to be wide divergence on regulatory approaches to cryptocurrencies. For investors, all this uncertainty promises an exhilarating ride ahead.

AMERICAS

A golden opportunity

The chance for international union with leading economies, particularly China, could level-set several problem areas critical to addressing climate change. Global standards are vital in a number of areas to tackle climate risks internationally, from rising sea levels, desertification of fertile land and severe damaging storms.

The Biden administration, admirably, has already taken steps to tackle several climate change issues. Last month, the president issued an executive order mandating federal agencies to understand potential impacts of climate change on public and private institutions and assets.

Governments around the world are dealing with the numerous voluntary standards that currently exist while continuing to implement climate risk disclosure requirements. Biden should build on the White House order by pushing for harmonised, global standards under which company climate risk disclosures would be reported.

Funds foibles

Read any financial publication, asset manager website or see myriad new ESG vendor reporting or measurement tools, and its obvious the market is supplying for this sustainable investing demand. ESG strategies claim to provide returns that offer the ability to "do well while also doing good," a clarion call for the virtues and benefits of investing in ESG strategies.

Alongside greater company climate risk disclosures, funds must more closely align to clear ESG metrics so investors know more about what they are buying. Greenwashing risks for funds- investments veiled as adhering to ESG metrics that indeed are misleading- remain. Clearer, standard metrics for funds

outlining how these investments measure ESG impacts are required.

Further research looking at whether ESG funds provide greater returns than counterparts over the long term, in times of uncertainty and market stress, is absolutely necessary. Proponents of greater ESG options point to research, which suggests that millennials are keen to invest in funds and causes for which they are passionate. That is great, but investors with this long a time horizon need to take every advantage of their human capital, and need greater transparency into if what they are buying will meet their financial goals.

Some research suggests that ESG strategies do provide better returns, fuelling the general perception that, in fact, ESG funds do provide outperformance over several years, and have exceeded other options during the Covid-19 pandemic.

The jury may still be out on whether ESG investments really provide greater returns. A report in May from Scientific Beta found no evidence that ESG strategies outperform.

Instead, researchers found that "sector biases and exposures to equity style factors capture the returns of ESG strategies," the authors wrote. In addition, the analysis suggests that returns are inflated when investor attention to ESG rises.

This isn't to say that ESG funds don't have value, far from it. Rather, authors wrote that while the findings don't question if ESG strategies can offer substantial value to investors. "Instead, they suggest that investors who look for added value through outperformance are looking in the wrong place."

Maybe when something seems like it could be too good to be true, it is. Investors may not like having to make these hard choices, and it's likely not a zero-sum choice between supporting one's ideals or achieving returns that emulate or excel the broader market, but investing, like almost anything else, is a matter of hard choices and balancing risk.

For certain – to paraphrase Kermit the frog – it isn't easy being green. But, for ESG product providers that's what they signed up for. Great claims, such as that ESG strategies outperform others, demand clear evidence. Otherwise, we're left spinning our wheels and never getting the clearest picture possible.

EUROPE

On amicable terms?

Looking at the EU and UK trying to patch up their relations feels a bit like watching a divorced couple trying to recreate a bond they should have never broken in the first place.

The truth is, the only way forward in the globalised world we live in is through cooperation, and certainly not through division. This is something that Trump's America failed to understand in its own time, and that Johnson's Britain is also failing to grasp.

If any tangible proof of this was needed, the Covid-19 pandemic was probably the best – and in many ways, the worst – example there could be. If one country gets its health policy wrong, the entire world is at risk of going back into a much-dreaded lockdown.

Another case in point, of course, is the climate crisis. One country's action will never be enough to reverse the entire planet's carbon emissions. A synchronised global movement, instead, could tip the balance and hopefully help us avoid running into an ever-approaching wall.

Member states' attitudes to risk-sharing and a common health policy, among other things, were two elements that cruelly lacked during the Covid-19 crisis – in the first instance, at least.

The thing is, whether they like it or not, the UK and the EU are bound forever. Be it physically via the Channel tunnel, or politically, economically and socially – by virtue of the countless commercial and cultural exchanges that occur between them on a daily basis.

The same goes for their financial services. Colossal and all-encompassing pieces of EU financial regulation such as Mifid II, for instance – which, incidentally, would not be what it is today without the UK's input – are proving a real headache to unbind.

With the enormous healthcare and environmental challenges that the world has to take on, the last thing that businesses need right now is more complexity on the basis of nationalism and sovereignty.

Yet, as we keep hearing from various experts, regulatory divergence has only started to take shape and many areas will continue to be contentious. Central to the debate these days are discussions around clearing and trading equivalence, which so far have all but opened the way for a single winner: the US.

In the coming months, the Mifid II review and the UK's new prudential rules for investment firms will also take center stage.

But as each side continues to drive its own regulatory agenda, a harsh reality will keep hitting them: that EU and UK policies are all but too intertwined to ever be fully independent from each other and self-serving.

OFF THE

RECORD

"There won't be divergence for divergence's sake. The UK has already diverged on SFDR, and one wonders if the EU is shooting itself in the foot by not granting the UK divergence"

A London based banking source discusses regulatory shifts following Brexit

"I suspect that there may be competing solutions, at least for a while, but hopefully that won't cause further uncertainty as the market tries to settle on a consistent way to calculate SOFR"

One New York based general counsel discusses the Libor transition in the US

"Only a tiny portion of banks are willing to actually do any direct marijuana banking"

The co-head of a law firm's financial institutions group discusses the problem of bankability in the cannabis sector

"It's been said that to comply with data laws in China you need a good government affairs team, whereas a good legal team is needed to comply with the GDPR"

A corporate lawyer in Hong Kong SAR discusses China's data laws

"Everybody understands that in China nobody has any privacy and the government spies on everybody all the time. So substituting WeChat or Alipay for a government CBDC isn't much of a leap"

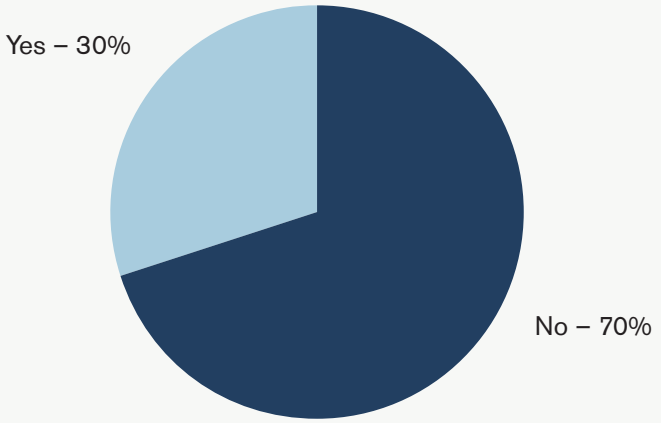
A US based digital currency expert discusses the privacy issues with a CBDC on page 20

Inside India's potential crypto ban

Respondents to this edition's market poll suggest that preventing investors from accessing crypto will only lead to more black money mayhem

By Karry Lai

Will a potential crypto ban in India actually prevent investors from accessing crypto?



IFLR polled readers on whether a potential cryptocurrency ban would actually prevent investors from accessing cryptocurrency or if a ban would be too difficult to enforce. Sources in the cryptocurrency market says that while such a ban would limit trading, it would only lead to more illegal access. What is needed is not a blanket ban, but strengthened cryptocurrency regulations.

In January, the Indian government introduced a bill that proposed a ban on cryptocurrencies except for a digital currency that the Reserve Bank of India (RBI) plans to issue. However, the bill has not been passed and there is speculation as to whether there will be a blanket ban or if a more balanced approach will be taken to allow for some cryptocurrency trading, but with stricter rules.

Since then, the government has also introduced new cryptocurrency disclosure rules, which became effective April 1, signalling a path towards more regulatory oversight in the future. The Ministry of Corporate Affairs has stipulated that every company that has traded or invested in cryptocurrency or virtual currency during the financial year has to disclose all cryptocurrency holdings, total profits and losses, and deposits or advances received from anyone trading or investing in cryptocurrencies.

The Indian government's desire to ban cryptocurrency is not new. In April 2018, the RBI prohibited Indian banks from providing services to cryptocurrency exchanges. The ban was lifted in March 2020 after the Supreme Court of India ruled against the RBI.

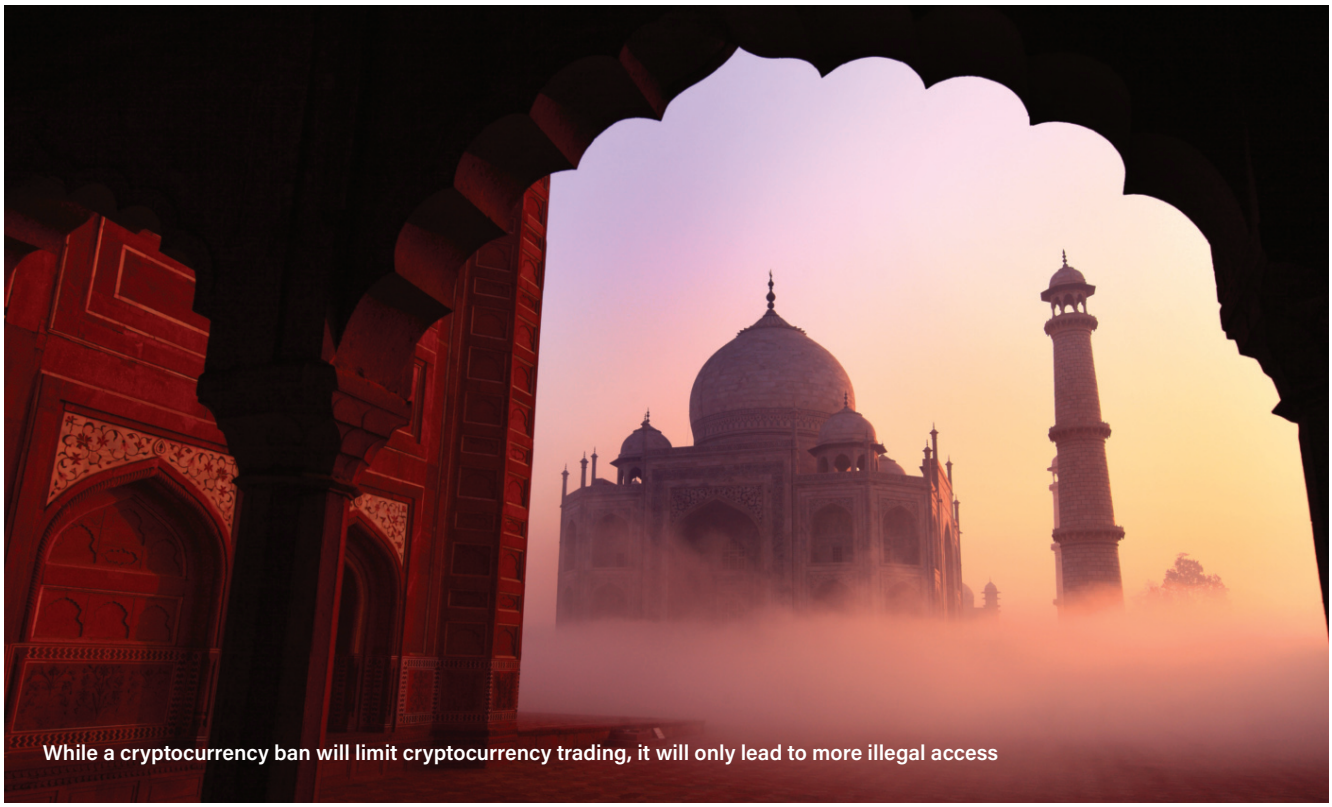
METHODOLOGY
IFLR publishes its quarterly poll question on iflr.com. Throughout the quarter, IFLR's editorial team gathers the responses and interviews selected respondents.

Sources in the Indian cryptocurrency market oppose a blanket ban, with some suggesting it will encourage people to go for peer-to-peer or cash transactions. "Considering that the Indian government wants to bring down the black money mayhem by encouraging people to go for digital transactions, a complete ban on trading on cryptos will defeat the larger purpose," says Rashmi Deshpande, partner at Khaitan & Co. "A complete ban will also prevent larger transactions like venture capital funding and this will set the country back by many years, if not decades."

Rishi Anand, partner at DSK Legal, agrees and says that if a complete ban were to be put in place, then, with the exception of enthusiasts, others would refrain from trading in the banned cryptocurrencies. "Traders and investors may lose an opportunity to earn returns and the government would correspondingly lose revenue on such income," he says.

In the case of a ban on cryptocurrency exchanges, there would be no legitimate sources for the government to get information on cryptocurrency trading in India and also to determine the tax to be collected. "If the legitimate institutions are banned, there will be no way the government will have any sources for obtaining information about such trading," says Deshpande.

Tashish RaiSinghani, founder at ValYou One Services, says that while a complete ban might stop



While a cryptocurrency ban will limit cryptocurrency trading, it will only lead to more illegal access

"Considering that the Indian government wants to bring down the black money mayhem by encouraging people to go for digital transactions, a complete ban on trading on cryptos will defeat the larger purpose"

some new investors from getting into the cryptocurrency space for a short period of time, it would definitely lead to huge illegal trading, akin to that seen during the RBI ban of cryptocurrency in 2018.

Sidharth Sogani, CEO at CREBACO, a research, rating and intelligence firm focused on blockchain and cryptocurrencies, says that he does not see the Indian government introducing a complete ban on cryptocurrencies, but a higher compliance ecosystem.

"The requirement on disclosure in April is a smart move," he says. "The government wants data so that it will be in a better position to make decisions related to the industry after it declares its crypto holdings."

In the event that there is a complete ban, which seems unlikely, Sogani says that it would lead to illegal trading and peer-to-peer cash trading would increase. "It will encourage a parallel economy," he says.

Sumit Gupta, CEO and co-founder at CoinDCX, says the move to more transparency is a great stride towards a regulated environment, which is what the industry has been eagerly anticipating. "This will help provide clarity to the government on how to regulate crypto-assets and increase transparency for all stakeholders," he says.

He continues: "Besides ushering in transparency for the system, it will also enhance the confidence of investors, both retail and institutional. It will act as a comfort for Indian companies which are dealing in crypto-assets and were previously confused on how to put it in their books."

Going forward, Anand says that the data gathered would likely be analysed and factored into the ongoing parliamentary debates on the cryptocurrency bill and may also influence policy on the grace period allowing cryptocurrency exits for investors.

According to RaiSinghani, the move towards disclosure will make cryptocurrency more legitimate and bring it towards the mainstream. "It will lead to making cryptocurrency a legal asset class – and policies on income taxes, and goods and services taxes will eventually decide the mood towards cryptocurrencies in India," he says.

Market participants in the Indian cryptocurrency market believe that a complete ban on cryptocurrencies is highly unlikely and suggest that it would only lead to more illegal trading and a parallel economy. What they are expecting to see is a move towards more regulation on cryptocurrencies; and the recent step by the Indian government towards disclosure is helping it to better understand the existing market before it takes further actions on regulation.

Navigating the turning point

Following Coinbase's successful direct listing on the Nasdaq exchange in New York, **IFLR** managing editor **John Crabb** sat down with chief legal officer **Paul Grewal**, deputy general counsel **Juan Suarez** and associate general counsel **Doug Sharp** to discuss the IPO, legal innovation and the future of the company

Thank you all very much for agreeing to this interview today. I will start with a nice easy question. You successfully listed on the Nasdaq in March, can you talk me through the IPO. Were there any bumps in the road or did things run to plan?

Paul: Well, firstly thank you for talking the time to talk to us today. As the chief legal officer, I have a number of opinions about how smooth the road was, but overall it was a far less eventful path to listing than we expected given the complexities we were confronting. The credit for almost all of that, if not all of it, goes to Doug, Juan and the others who lead the corporate legal team here at Coinbase.

When we first kicked off our work to become a public company, we were aware that there would be a number of unique challenges for Coinbase, separate from the challenges that every company looking to go public faces. First, we would be the first crypto company – certainly of our scale – to go public, particularly in terms of giving proper assurances to the securities regulators that we were in shipshape for life as a public company. That presented some unique challenges.

We also made a decision relatively early on in the process to pursue a direct listing rather than a traditional IPO. That added its own complexities in that there has only been a handful of other companies that have successfully made the transition in that way. The third stand out challenge that we confronted along the way was the rapidly shifting institutional and public appreciation for crypto, including bitcoin, as a viable, and indeed an important, asset class.

Over the course of this period, we also saw not quite a sea change but a major shift in attitudes among important

institutional stakeholders about our entire industry and the opportunity it presents. That created challenges along the way that we may or may not have entirely expected when we got started.

Could you talk me through the decision to opt for a direct listing rather than a more traditional IPO route?

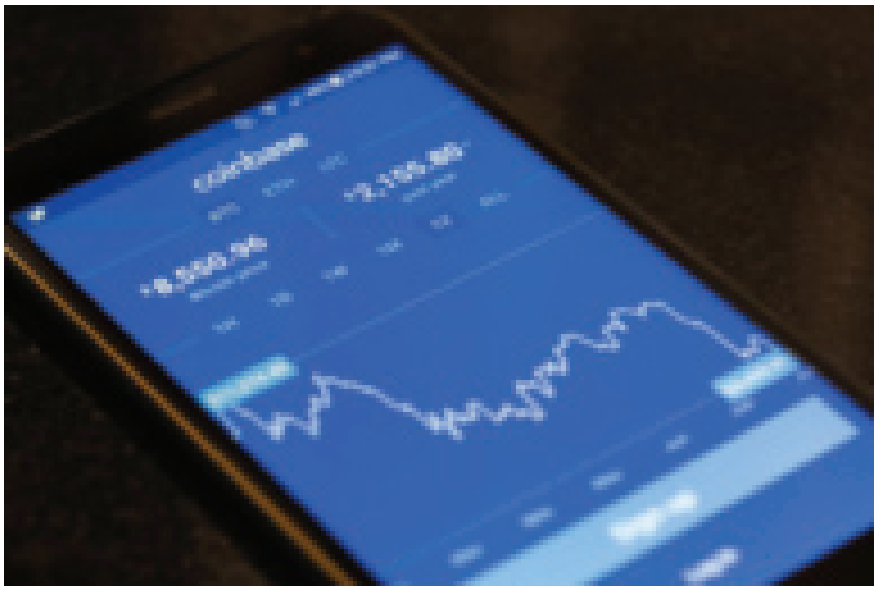
Juan: There were two main reasons. Firstly, with a conventional IPO the prevailing goal for companies is to raise money. Coinbase has been tremendously fortunate and successful so far, so we did not feel that there was a need to go through a traditional IPO route to raise funds.

Secondly, a huge part of what we are all here to do is to increase economic freedom in the world and open up the financial system for greater participation. We liked the idea of a direct listing, which is a genuine price discovery auction process, where we go straight to the market and sell the company stock without a lot of intermediation through bankers or underwriters. It is consistent with the thematic of the business and we thought it was a very much an on-brand way to take the company public this way. We were excited to be among the first group of companies to explore this model.

You just said that the kind of the goal was not to raise money as such. So what was the goal behind the idea of listing?

Juan: Taking a company public is a natural part of the trajectory for any growing business. We felt this was another important milestone in the growth and maturation of Coinbase. Direct listings make liquidity available to shareholders and employees of the business, which is an important part of the evolution of any business.

We have reached a level of maturity unmatched by any other crypto businesses, in that we are a public reporting company and registered with the SEC [Securities and Exchange Commission]. As such, we see this as an important threshold to move through but obviously is not an end unto itself. This was one milestone along the journey, there is of course a lot more work to do but we feel very proud of the work we've done and the success of the of the listing.



Was that decision tied to your choice to opt to list on the Nasdaq?

Doug: We were excited by the Nasdaq team. We used their private market platform to help drive price discovery prior to the direct listing and their technology is very good. There were a number of attractive factors, one of which was that we were able to secure the COIN ticker with them, which was an important branding moment for us.

In the run up to the IPO, I saw commentary on social forums from people suggesting it would have been more appropriate for Coinbase to use a different way to register the IPO, suggesting that using a blockchain would have been more of a statement for your support of the technological side of things. Did you consider this? Is there a way the entire process could be modernised to incorporate new financial technologies?

Paul: We think the opportunity for companies to list their equity securities in the form of tokens on Coinbase is extremely important for the future, and something we are very interested in pursuing. We are talking to regulators and others about how best to go about that, and we are very eager to help crack that nut.

Juan: Although this was not part of the S-1 form, Coinbase is very interested in exploring the realm of opportunity and blazing a trail in the world of tokenised securities. This is part of the reason that we invested in – and continue to invest in – a broker dealer and alternative trading system (ATS) that will enable the trading of tokenised equity securities.

Following on from this, can you explain the reason to acquire Keystone Capital Corp in 2018?

Juan: There is a huge opportunity in the security markets as far as blockchain technology is concerned. There are unique opportunities to change settlement timelines, access level liquidity, and at a fundamental level, increase efficiencies and change the way trading, and even capital formation, can work. We are at the extreme early stages, still exploring the realms of possibility in the securities markets and what technology can unlock.

Our view is that if Coinbase does not take a lead on trying to solve some of these hard questions and perform some of these early stage products around blockchain and in securities, then who will? We do not think that there is another company out there putting the kind of resources into the necessary relationships with the regulators or into the first principles of legal work that we do, just to allow this to work.

"One stand out challenge that we confronted along the way was the rapidly shifting institutional and public appreciation for crypto, including bitcoin, as a viable, and indeed an important, asset class"

- Paul Grewal

We are excited to be the vanguard of what could be an exciting new technology. The critical thing we need is a home for tokenised securities to trade in a manner that is compliant with US securities laws. The acquisition is one piece of a puzzle that will allow us to launch these products.

Paul: We are unwilling to offer these products and services in a manner that is not compliant with the law. We are more than willing to try and fail as a matter of market acceptance and customer demand. With those two principles firmly in mind, Coinbase is uniquely situated to make these things happen – but it is important that we do so in a way that is consistent with our core principles.

Earlier in the year, I wrote an op-ed that stated the Coinbase IPO would be a turning point for the crypto industry, arguing that the additional regulatory oversight you would get from being a listed company would be an important step in the evolution of the sector. Is this something you agree with, do you think this is a turning point?

Paul: I certainly agree that the Coinbase listing was a big moment, not just for Coinbase, but for the industry as a whole. The recognition that crypto has not just arrived but it is here to stay really will benefit both the crypto industry and the crypto economy as a whole. I fully agree with that statement.

For companies beyond Coinbase, and individuals interested in crypto on Coinbase, the listing is a recognition that regulators, policymakers, and industry, now have common cause to figure out how to make some of these products and services work in ways that matter to real people to solve real problems. In that sense, it was an important milestone for everyone interested in the success and proliferation of crypto.

In September 2020, Bryan Armstrong said that Coinbase is a mission-focused company – focused on expanding the use of crypto. What steps has Coinbase taken to do that lately, besides from the IPO?

Juan: We have taken a 'crawl, walk, run' approach to developing opportunities in crypto for our users and our customers. Trading has proven to be an important first step for us and for the wider industry, but the greater excitement and our long term focus is on products that go beyond simple trading to include other products like credit lending and securities, for example. We believe these things belong in the crypto economy in a compliant to regulatory way.

Beyond financial services, we also think that the blockchain itself offers some fundamental opportunities to solve problems that go far beyond just the saving, investing or spending. That is why, for example, we recently announced that we are committing 10% of our resources to moonshots that will focus on long term bets that may not bear fruit for years, but that we think are important for the state of the art.

Shortly before the IPO, the crypto exchange Binance listed a stock token called "COIN" which allowed exchange users to trade fractional Coinbase shares. Is that something they discussed with you beforehand?

Doug: We have not discussed with that with them, and we do not really have much to say about it.

Paul: As Doug says, it is not really something we have any say or frankly, much interest in.

You recently announced that you would list Tether, or USDT, a coin that has had its fair share of criticism. What was the decision behind that and is this an indication that you support the project despite the inquiry from the New York State Attorney General?

Paul: We have come to appreciate and understand that there is a great deal of interest among our customers in having access to Tether on our platform. Obviously, we were very interested in meeting that demand and providing optionality when it comes to Tether where appropriate. We were very clear that we would be listing USDT on Coinbase Pro, but only in a manner consistent with the conditions that we laid out in our announcement.

The main thing I would just say about that decision is that we are well aware of the regulatory interest in USDT, and certainly pay very careful attention to what regulators have to say about it. We are confident we can offer Tether in a way that respects the needs of our regulators, and meet the strong market demand for the asset.

There have been suggestions that some of the management team, including you Paul, were dumping shares post-IPO for maximum gain. What do you make of the claims?

Paul: I have all kinds of thoughts, which appeared on Twitter, but will happily elaborate on. Firstly, I have no shares to sell so did not personally do this. For those executives who chose to sell a relatively small portion of their overall equity position in the company, the misrepresentations really speak to at best an ignorance and perhaps at worst, a willingness on the part of some to create a lot of fear, uncertainty and doubt.

In a direct listing, it is very clear; in fact, it is critical that the shareholders provide liquidity and supply on first day. The whole point of a direct listing is to create that market. The people who are in that position to create that market include the existing shareholders. Among them, of course, are employees of the company.

The second thing is that those representations fundamentally misstated the overall positions that certain individuals have in Coinbase stock. To suggest that there somehow was a dump is itself a loaded term that did not accurately capture the relatively modest transfer of shares that most or all of those executives did.

The best way to understand this is to look at other direct listings and how other executives and companies have approached those. If you look at any number of direct listings that have taken place up until this point, you can see that the percentage of positions sold by Coinbase executives were entirely in line, in fact even slightly on the low side, as compared to others. We are very comfortable that everything that happened here was entirely appropriate and we think it is important to correct that record. This is why I spent my whole Sunday on Twitter arguing my case.

The stock price has dropped by nearly $100 a share in value since the listing, after trading well over $400 a share at one point. What should readers and investors make of this? Is it indicative of the health of the crypto market overall and do you think the two are linked?

Paul: Well, I pay very little attention to the price of Coinbase shares on the open markets, largely because we leave it to the market to tell us its view of our long-term prospects. Our own views are very positive; we are focused on building the company to be strong and resilient. We talk a lot internally about focusing on the mission of the company as you mentioned, so the best thing we can do for shareholders is pay less attention to where the stock price might be on any given day, and more attention to how new products and services are going to work. This will better serve those shareholders in the crypto economy as a whole.

Going back to the "mission focus" of Coinbase and the marked decision to not take a social stance. Do you think it is right that Coinbase does not focus on ESG issues or things like racism, even if customers expect it?

Paul: Brian has very clearly stated that as a company, Coinbase is focused on issues that will drive or impact the proliferation of the crypto economy. To the extent that ESG concerns raised publicly or by regulators would impact Coinbase we are more than happy to engage with them. We are very proud of our record on those issues, but what we are not going to do is get distracted by issues that lie outside of the remit of our fundamental purpose as a company, which is to grow the crypto economy.

We will engage with those topics as raised and as necessary, but we will remain focused on the mission of building an economy that works for everyone. We are not going to be distracted by discussions that are ancillary or irrelevant to that.

Excellent, thank you very much for your time today and I look forward to seeing what Coinbase comes up with next.

Paul: The only thing I will say in conclusion, in addition to saying thank you, is that we could not be more excited about the future of crypto. As a legal team, we have been privileged to be able to play a significant part in the company's access and we will continue to focus on that going forward.

"If Coinbase does not take a lead on trying to solve some of these hard questions and perform some of these early stage products around blockchain and in securities, then who will?"

- Juan Suarez

IFLR AWARDS 2021 AMERICAS

Congratulations to all the winners of the IFLR Americas Awards 2021

Cleary Gottlieb once again lifted the trophy for 2021 Americas Firm of the Year. The firm also picked up debt and equity-linked team of the year and big deal wins for its work on Ecuador's sovereign debt restructuring and the LATAM Airlines DIP financing.

Simpson Thacher was another of the big winners, taking home an unassailable three team of the year wins in equity, M&A and private equity, as well as being nominated for CFIUS team of the year. Its winning deals included Infineon' acquisition of Cypress, Airbnb's IPO and KKR acquisition of Coty's professional beauty business.

Davis Polk scooped high-yield team and the highly competitive financial services regulatory team of the year award. Kirkland & Ellis, Clifford Chance and White & Case won the restructuring, project finance and CFIUS team awards, respectively. Ropes & Gray impressed in several categories and took a deal and team win for its structured finance and securitisation work.

Canada's 2021 firm of the year was Goodmans.

The Contribution to regulatory reform award went to Katherine Tew Darras of ISDA, for her work on interbank lending rates (Ibor) and the ISDA IBOR Fallback Protocol

and previous work implementing Dodd-Frank and countless over regulations impacting the derivatives space. The Outstanding achievement award went to Shearman's Antonia Stolper, recognising her near three decades of work across Latin America.

Bank of America and Morgan Stanley won the debt and equity in-house team awards, respectively.

Big national winners in Latin America included Creel for Mexico, Pinheiro Neto for Brazil, Brigard Urrutia for Colombia, Claro & Cia for Chile and Bruchou for Argentina. Other impressive wins came for Peru's Rodrigo Elias & Medrano Abogados, Marval O'Farrell Mairal, Garrigues and Consortium Legal.

The full list is below. Congratulations to all the winners:

Law Firms of the Year

Americas firm of the year

Cleary Gottlieb Steen & Hamilton

Individual Awards

Outstanding achievement award

Antonia Stolper – Shearman & Sterling

Antonia Stolper has been a pioneering force in Latin American capital markets for almost 30 years. She started her career with a JD from New York University School of Law before joining Shearman & Sterling in 1991, where she continued to work in 2021. She has spearheaded Shearman's efforts in Latin America as its regional managing partner. In January 2021, Antonia stepped back from the front line, becoming an of counsel.

Antonia has been a leader not just in terms of her legal work but also as a champion for pro bono. In her advice to the Climate Bonds Initiative in establishing standards for financing the transition to a low-carbon economy and in her tireless effort to improve the status of women in the legal profession, she continues to break boundaries. She has also served on the Board of Directors of the Council of the Americas.

Some of her most challenging recent work has been in relation to the restructuring of Argentina's sovereign debt. Indeed, peers consistently praise her ability to be able to coalesce clients from different walks of life around a common view, even in fraught and high pressure circumstances.

Contribution to regulatory reform

Katherine Tew Darras – ISDA

ISDA has played a vital role in all the crucial reform seen in the derivatives space in the last few years. As general counsel to the association, Katherine Tew Darras has played an instrumental role in helping ISDA to achieve this.

One of Katherine's key priority areas over the last 10 years for ISDA has been to facilitate compliance with Dodd-Frank and global regulatory frameworks related to the derivatives markets. Since 2016, Katherine and her team have also been working to address the risk if one or more interbank lending rates (Ibors) permanently ceases to exist or, in the case of Libor, is deemed to be non-representative before firms have transitioned to alternative reference rates.

In 2020, Katherine played an instrumental role in the development of a fallback adjustment and in the publication of the ISDA IBOR Fallback Protocol, which put in place a critical safety net that allows market participants to proceed with benchmark transition in case a contract continues to exist which references a Libor rate. She was also pivotal in ISDA's publication of a suite of documentation to facilitate compliance with SEC Dodd-Frank rulemakings. These and other ISDA priorities have ensured that the markets that ISDA's members transact in continue to be safe and efficient.

Deals of the Year

Debt and equity-linked

Ecuador debt restructuring

The successful $17.4 billion restructuring of Ecuador's sovereign debt was one of the most challenging and significant transactions of the year. The restructuring was completed in August 2020 after six months of negotiations with international creditors on several fronts. The case paralleled the restructuring of Argentina's debt, providing global markets with two different examples of how to approach, interpret and apply the latest legal provisions that can be used in sovereign debt restructurings. Ecuador provided was one of the first tests of collective action clauses (CACs) in a sovereign bond restructuring; the litigation ruling by Judge Caproni was the first ruling by a New York court on the use of CACs to effectuate such a restructuring. The restructuring also reprofiled Ecuador's debt with China and complied with a stringent set of IMF policies and guidelines.

Law firms

Cleary Gottlieb Steen & Hamilton – Citigroup Global Markets
Hogan Lovells – The Republic of Ecuador
Pérez Bustamante & Ponce – Citigroup Global Markets
Perkins Coie – Trustee (The Bank of New York Mellon)
White & Case – Ad hoc bondholder group

Equity

Airbnb IPO

Airbnb's December IPO had a host of innovations. The IPO included over 30 underwriters. It involved a high profile and high value listing of a travel dependent company, just as Covid-19 was upending global capital markets and putting a freeze on global travel. The IPO rode a market that jumped from one extreme to another, resulting in 76 pages of risk factors in the registration statement. Among the IPO's many innovative features were the use of an online platform for deal pricing ahead of the listing, a directed share program to reach tens of thousands of Airbnb hosts, the creation of four classes of common stock (including a Series H, for hosts), and the establishment of a foundation using 400,000 shares of Class A common stock. The stock release and lock-up structures offer the market interesting new templated, the latter using amendments to the company's governing documents to expedite the lock-up process.

Law firms

Latham & Watkins – Airbnb
Simpson Thacher & Bartlett – Underwriters (Morgan Stanley and JP Morgan)

High yield

Delta Air Lines senior secured notes

Delta Airlines senior secured notes were built on a capital raising strategy that

confronted the turmoil created by Covid-19 and offered other airlines in the market alternative solutions to liquidity issues other than state support programmes. The April 2020 high-yield notes were secured by slots, gates and routes, while a company reorganisation carved out Delta's loyalty plan into a separate bankruptcy remote entity, which could then raise its own financing. Unlike some other airlines, Delta's loyalty plan was integrated into the company, so the carve-out had to be executed without interrupting Delta's business. It also had to ensure that the structured finance lenders would have a share in the loyalty plan financing stream. The strategy enabled Delta to raise financing in two ways and provided a route that other carriers could follow.

Law firms

Davis Polk & Wardwell – Delta Air Lines
Dorsey & Whitney – Delta Air Lines
Kilpatrick Townsend & Stockton – Delta Air Lines
Milbank – Initial purchasers (JP Morgan)

Loans

LATAM Airlines DIP financing

The $2.45 billion debtor-in-possession (DIP) financing for LATAM Airlines involved a range of complex cross-border issues given the international nature of LATAM's operations and jurisdictions of incorporation. LATAM is a Chile-based company with non-US affiliates. The case triggered some of the first recognition proceedings in Chile and Colombia, as well as representing one of the first Brazilian-incorporated debtors to seek relief in the United States. The deal used a novel strategy to restructure the company under Chapter 11, which allowed it to continue operating while seeking DIP financing and renegotiating its contracts. The financing involved a multi-tranche facility backstopped by certain large shareholders, followed by a competitive process to raise over $2 billion of debt. The convertible DIP structure, where lenders could be repaid in discounted shares of the reorganised company, was subsequently adopted in the Avianca and Aeromexico bankruptcies and will have broad future implications.

Law firms

Alston & Bird – Qatar Airways
Brigard Urrutia – LATAM Airlines, Aerovías de Integración Regional and Línea Aérea Carguera de Colombia
Cescon Barrieu – Oaktree Capital Management
Claro & Cia – LATAM Airlines
Cleary Gottlieb Steen & Hamilton – Oaktree Capital Management
Dechert – Unsecured creditors' committee
Demarest – LATAM Airlines
DLA Piper Martínez Beltrán – Oaktree Capital Management
Hogan Lovells – Knighthead Capital Management and Repsol
Latham & Watkins – Jefferies
Mattos Filho Veiga Filho Marrey Jr & Quiroga Advogados – Qatar Airways
Morales & Besa – Unsecured creditors' committee
Quinn Emanuel Urquhart & Sullivan – Knighthead Capital Management
Wachtell Lipton Rosen & Katz – Costa Verde
White & Case – Oaktree Capital Management

M&A

Infineon Technologies / Cypress Semiconductor

Infineon's painstakingly documented $10 billion acquisition of Cypress writes the playbook on how to manage a large, sensitive, cross-border acquisition in the midst of extreme market, and therefore deal, uncertainty. The deal was signed in June 2019 and closed in April 2020 at the first of a series of drop-dead dates. Cypress manufactures semiconductors for 5G telecoms, industrial and defence systems, automotive products, and the internet of things, among other industries, so the acquisition by Infineon faced intense scrutiny from the Committee on Foreign Investment in the United States (CFIUS), as well as being on the political radar. It secured merger authorisations from US, European and Chinese antitrust regulators and did not drop a beat despite the US-China trade tensions and Covid-19 volatility. All this was achieved by pushing covenants, drop-dead date timetables and reverse break-fee structures (which included a CFIUS-specific provision) to their maximum potential.

Law firms

Fangda Partners – Infineon Technologies
Freshfields Bruckhaus Deringer – Infineon Technologies
Kirkland & Ellis – Infineon Technologies
Simpson Thacher & Bartlett – Cypress Semiconductor Corporation
Sunland Law – Cypress Semiconductor Corporation

Private equity

KKR / Coty's professional beauty business

KKR acquired Coty's professional beauty business, which includes Wella, in October 2020. The acquisition combined a global carve-out to extract the businesses from Coty – a public company – into a standalone entity, a joint-venture and a co-investment agreement. In a two-step process, KKR invested in Coty (a private investment into a public entity – PIPE) using convertible preferred shares and signed an MoU for the purchase of a majority stake in the business. To limit KKR's risk, the PIPE and MoU operated in tandem, with a prescribed date for an additional tranche of investment if the Wella deal went forward on a specific timeline. This was an innovative structure to execute, especially on such a global deal, with businesses spanning Europe and Latin America. In Brazil alone, a key hub for Latin America, the deal used unprecedented structuring to separate the consumer and professional businesses, manufacturing facilities and employees and to create an unprecedented transfer period.

Law firms

Baker McKenzie – KKR
Bruchou Fernández Madero & Lombardi – Coty
Creel García-Cuéllar Aiza y Enríquez – Coty
Lefosse Advogados – Coty
Pietrantoni Mendez & Alvarez – Coty
Simpson Thacher & Bartlett – KKR
Skadden Arps Slate Meagher & Flom – Coty
Trench Rossi & Watanabe – KKR

Project finance

Red Vial 4 highway and Chimbote bypass

This is the $350 million financing of the Red Vial 4 highway network and the Chimbote bypass in Peru. The deal, which included the first toll road financing in Peru in over five years, involved a significant number of creditors, including commercial lenders and the Inter-American Development Bank (IDB), and spanned multiple jurisdictions, including Peru, the US (New York) and Spain. The

transactions combined a refinancing with a full new financing tranche. The deal required consent from the Peruvian regulator and the grantor for an amendment to the concession agreement, and private and public (notarised) execution of documents across all the key jurisdictions. Among the unique challenges the deal confronted were the enactment of a decree suspending the collection of fees from toll roads, which turned out to be an illegitimate decree, and a substantial construction risk component related to the carwash scandal. The deal relied on innovative structuring to hold these elements together and close in last year's market conditions.

Law firms

Baker McKenzie – Autopista del Norte and Aleatica Group
Clifford Chance – Lenders (SMBC, Credicorp Capital Servicios Financieros, Banco de Crédito del Perú, Banco Santander, Itaú Corpbanca, IDB Invest, CA-CIB and ING Bank)
Estudio Echopar – Autopista del Norte and Aleatica Group
Garrigues – Lenders
Herbert Smith Freehills – Cofides (Compañía Española de Financiación del Desarrollo)
Rodrigo Elias & Medrano Abogados – Cofides

Restructuring

McDermott International

McDermott's restructuring was a vast exercise in its breadth and depth. The restructuring pulled the company and 225 of its subsidiaries and affiliates, including 107 foreign domiciled entities, through prepackaged Chapter 11 cases in the US Bankruptcy Court of the Southern District of Texas. At the time of filing, McDermott, a global engineering, procurement, construction and installation company, employed over 42,000 individuals across 54 countries and six continents. Key aspects of the case included negotiating a new emergency facility with several secured lenders worth $1.7 billion, thereby avoiding a potentially catastrophic bankruptcy. Once under Chapter 11, the case reconciled the diverging demands of LC issuers, term lenders and bondholders to enable a fully consensual restructuring. The deal struck equitized over $4.6 billion of debt and consummated the $2.7 billion sale of McDermott's Lummus technology business to private equity buyers. It represents a monumental cross-border effort to achieve a consensus-based result.

Law firms

Alfaro Ferrer y Ramirez – Ad hoc group
Appleby – McDermott International
Arias Fábrega & Fábrega – McDermott International
Arthur Cox – McDermott International
Baker Botts – McDermott International
Baker McKenzie Wong & Leow – McDermott International
Bennett Jones – McDermott International
Bracewell – DIP LC agent
Brown Rudnick – Consenting noteholders
Carey Olsen – McDermott International
Clarke Gittens Farmer – McDermott International
Cleary Gottlieb Steen & Hamilton – Other Creditor Constituencies
CMS – McDermott International
Conyers Dill & Pearman – Ad hoc group
Cornejo Méndez González y Duarte – McDermott International
Covington & Burling – Wilmington Trust
Creel García-Cuéllar Aiza y Enríquez – CA-CIB, Barclays Bank, Royal Bank of Canada, ABN Amro and Wilmington Trust
Davis Polk & Wardwell – Ad hoc group
DLA Piper – McDermott International
Freshfields Bruckhaus Deringer – McDermott International
Ganado Advocates – McDermott International
Haynes and Boone – Lloyds LC Bank and other creditor constituencies
Holland & Knight – McDermott International
Howley Law – Other Creditor Constituencies
Jackson Walker – McDermott International
Jones Day – Other Creditor Constituencies
King & Spalding – Other Creditor Constituencies
Kirkland & Ellis – McDermott International
Latham & Watkins – DIP Term Loan Agent (Barclays Bank)
Law Office of Mohanned bin Saud Al-Rasheed in association with Baker Botts – McDermott International
Linklaters – DIP LC agent
Locke Lord – DIP Term Loan Agent (Barclays Bank)
Mattos Filho Veiga Filho Marrey Jr & Quiroga Advogados – CA-CIB, Barclays Bank, Royal Bank of Canada, ABN Amro and Wilmington Trust
Mayer Brown – McDermott International
McInnes Cooper – McDermott International
NautaDutilh – McDermott International
Ogier – Ad hoc group
Paul Weiss Rifkind Wharton & Garrison – Chatterjee Group and Rhône Group
Pillsbury Winthrop Shaw Pittman – Chatterjee Group and Rhône Group
Porter Hedges – Ad Hoc Group
Rapp & Krock – Ad Hoc Group
Tauil Chequer – McDermott International
Walkers Group – McDermott InternationalWeil Gotshal & Manges – Other Creditor Constituencies
Wikborg Rein – McDermott International
Wong & Partners – McDermott International

Structured finance and securitisation

Sotheby's art loans securitisation

This transaction consisted of a $1 billion refinancing of the Sotheby's Financial Services art loan receivables with an expanded group of lenders. The borrower, under the refinanced securitisation, was a newly formed special purpose entity (SPE), supported by several parent entities through a performance guaranty and letters of credit. The facility was secured by loan receivables related to loans that were originated by various Sotheby's entities and secured by works of art and other collectibles consigned or sold at auction. The receivables, and future receivables, were sold to the SPE at closing. The highly bespoke deal raised novel issues in terms of valuing the collateral pool and ensuring that the credit support provided by the parent entities did not violate US or European risk retention rules or compromise the entity's bankruptcy-remote status. The deal enabled Sotheby's to monetise loans it makes to art dealers on an ongoing basis and reconciled the bespoke requirements of Sotheby's and the disparate global borrower base with stringent securitisation regulations.

Law firms

Ropes & Gray – Bidfair and Sotheby's
Sidley Austin – Administrative agent and lender

Teams of the Year

Debt and equity-linked
Cleary Gottlieb Steen & Hamilton

Equity
Simpson Thacher & Bartlett

High yield
Davis Polk & Wardwell

Loans
Shearman & Sterling

M&A
Simpson Thacher & Bartlett

Private equity
Simpson Thacher & Bartlett

Project finance
Clifford Chance

Restructuring
Kirkland & Ellis

Structured finance and securitisation
Ropes & Gray

CFIUS
White & Case

Financial services regulatory
Davis Polk & Wardwell

National Law Firms of the Year

Argentina
Bruchou Fernández Madero & Lombardi

Brazil
Winner: Pinheiro Neto Advogados

Banking & finance firm of the year: Mattos Filho Veiga Filho Marrey Jr & Quiroga Advogados
Capital markets firm of the year: Pinheiro Guimarães Advogados
Corporate firm of the year: Pinheiro Neto Advogados
Restructuring: Machado Meyer Sendacz Opice

Canada
Winner: Goodmans

Banking & finance firm of the year: Blake Cassels & Graydon
Capital markets firm of the year: Osler Hoskin & Harcourt
Corporate firm of the year: Davies Ward Phillips & Vineberg
Restructuring firm of the year: Goodmans

Central America (excl. Panama)
Winner: Consortium Legal

Banking & finance firm of the year: Arias
Capital markets firm of the year: Consortium Legal
Corporate firm of the year: Consortium Legal

Chile
Claro & Cía

Colombia
Brigard Urrutia

Costa Rica
Arias

Dominican Republic
Headrick Rizik Alvarez & Fernandez

Ecuador
Pérez Bustamante & Ponce

El Salvador
Arias

Guatemala
Consortium Legal

Honduras
Arias

Mexico
Winner: Creel García-Cuéllar Aiza y Enríquez

Banking & finance firms of the year: Creel García-Cuéllar Aiza y Enriquez
Debt and equity-linked firm of the year: Mijares Angoitia Cortes y Fuentes
Equity firm of the year: Creel García-Cuéllar Aiza y Enriquez
Corporate firm of the year: Galicia Abogados

Nicaragua
Consortium Legal

Panama
Alemán Cordero Galindo & Lee

Paraguay
Ferrere

Peru
Rodrigo Elias & Medrano Abogados

Uruguay
Ferrere

Andean states
Banking & finance firm of the year: Garrigues
Capital markets firm of the year: Pérez Bustamante & Ponce
Corporate firm of the year: Rodrigo Elias & Medrano Abogados

Southern cone
Banking & finance firm of the year: Claro & Cia
Capital markets firm of the year: Bruchou Fernández Madero & Lombardi
Corporate firm of the year: Marval O'Farrell Mairal

Rising Stars of the Year

Global firms
Augusto Ruiloba – Shearman & Sterling
Mariana Estevez – Clifford Chance

National firms
Camila Carvalho Gomes – Pinheiro Neto Advogados
Camilo Gerosa Gomes – Machado Meyer Sendacz Opice
Laura Ricardo Ayerbe – Brigard Urrutia

In-House Teams of the Year

In-house debt
BofA Securities

In-house equity
Morgan Stanley

IFLR1000

WOMEN LEADERS

2021

THE GUIDE TO THE WORLD'S LEADING FEMALE FINANCIAL AND CORPORATE LAWYERS

PUBLISHED
April 2021

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EVENT REVIEW

The 18th annual IFLR European Capital Markets Forum

This year's European Capital Forum was held virtually on May 25 and 26, here EMEA reporter Natasha Teja gives a run through of the two day event

Overview of the capital markets landscape

In the European capital markets, 2020 was a year marked by the uncertainties of both the Covid-19 pandemic and the Brexit process. "It seems that Brexit could remake financial centres across Europe in the coming year," said Notis Sardelas, partner at Sardelas Petsa Law. If there is a shift it will be a slow one, he continued. Companies with an obvious listing venue will usually list in their home markets first and foremost. In spite of this, European markets are seeing a shift from the UK to the EU in trading volume, however, for investment banking and prospective listings, London continues to overshadow its European rivals.

The panellists also spoke about the noticeable rise in SPACs in Europe, especially listings in Germany and Holland. However, the numbers remain minuscule compared to that of the US. 2021 has also seen a recovery in the global IPO market, which has had a record year to date. Q1 figures show that global IPO volumes rose 85% and proceeds raised via IPOs raised 271% year on year.

2021: The Libor transition

Panellists during the Libor transition session discussed the outstanding challenges that will occupy market participants during the seven months that separate them from the rate's discontinuation in most currencies. Particular attention was given to the struggles facing legacy debt products that require consent solicitations to transition, and how the delay of the sterling Libor tough legacy fix has had a negative effect on market efforts.

"Looking at the consultation timeline, the FCA rules won't be available until the fourth quarter of this year," said Veena Patel director and senior counsel at Rabobank. "For us it's still wait-and-see. We can't really progress our transition analysis until we know what those rules are going to be. We are very optimistic about what we can do once the

legislation comes forward, but it's still a delay where we were requiring further clarification that is just not there."

Antoine Bouvet from ING, Ian Fox from Lloyds Bank, and Olivier Favre from Schellenberg Wittmer also discussed the pros and cons of credit-sensitive rates, and how the US market's lack of consensus around a single replacement rate could be playing a major role in slowing down the USD Libor transition.

The Mifid II review

During this session, panellists discussed the Mifid II review and how it has progressed so far. Retail investors have reduced participation in various segments of the market, especially bonds. There is a tricky balance where retail investors have more protection but less freedom and vice versa for institutional investors.

The European Commission has suggested reducing protection and increasing freedom for investors that fall in between retail and institutional investors. In the equity capital markets space, another issue is accelerated book build as it pertains to secondary listings.

Sustainable growth and ESG in the capital markets landscape

Panellists during the session discussed the rising role that ESG is playing in the capital markets. More than a year since the Covid-19 pandemic began, ESG considerations and sustainable financing have reshaped capital markets and reoriented capital towards the green economy. Europe is leading the way in this with the creation of the EU taxonomy, ICMA Green Bond Principles and the Sustainable Finance Disclosure Regulation (SFDR).

It is not only public institutions that are creating ESG frameworks, however, but private companies establishing their own in-house framework. "We need to remember that ESG nowadays is a risk measure," said Heikki Cantell, general counsel at Nordic Investment Bank. "When we look at our activities, we need to also take into consideration ESG compliance also because it is now a risk factor."

A poll conducted at the forum found that 67% of our attendees already have an ESG framework in place in their organisation, while the rest are currently or considering establishing one.

While it is clear that there is a reorienting of capital towards more green investments, it is too soon to tell what the material impact on climate change is.

A look at debt capital markets

During this final session, panellists discussed the effects of Brexit on debt instruments, delving into whether the UK's exit from the EU has affected issuers of listings securities. The impact of Brexit has been minimal despite the expectation that more companies have chosen dual listings, opting to have one listing the UK and one in continental Europe.

Two years after the announcement of the risk factors for the prospectus regulation, panellists discussed the pain points for issuers since its implementation. "This risk factor discussion is still causing concern to issuers and law firms. Despite the fact that ESMA has issued quite detailed guidance," said Carlo Oly, head of relationship management at the Luxembourg Stock Exchange. One of the key concerns is that the large scope for interpretation is causing an uneven playing field.

COVER STORY

The digital arms race

As central banks around the world scramble to get ahead in the race to establish a Central Bank Digital Currency, three key issues have arisen: data privacy, legal status and interoperability

By Natasha Teja

From China to the US, countries from around the world are starting to form their own digital currencies. A central bank digital currency (CBDC) is a digital form of a country's fiat currency. Unlike cryptocurrencies, a CBDC is a centralised currency under the purview of a country's regulatory authority.

According to the Bank of International Settlements (BIS), over 80% of the world's central banks are at least conducting research on a digital currency, with most progressing to the experimentation and pilot stages.

The US Federal Reserve has announced intentions to release a research paper by summer 2021 as the next key step to issuing its own CBDC. "Society has been experimenting with cryptocurrency and digital money for the last 10 years, and central banks have actually been slower than society to recognise this change, but they are now recognising this change," says Chris Giancarlo, senior counsel at the Digital Dollar Project and former chair of the Commodity Futures Trading Commission.

The Digital Dollar Project is a foundation based in the US to advance the exploration of creating a CBDC for the country. The project is a collaboration between Accenture and the Digital Dollar Foundation. In May 2021, the project announced the launch of at least five pilot programmes over the next 12 months.

On the other side of the world, China is much further ahead in its development of the digital yuan - also referred to as e-CNY - which has been in the works since 2014. By May 2021, China had launched real-world testing of its CBDC in several cities.

The Chinese central government plans on commercially releasing the digital yuan ready to be used by the winter Olympics in 2022. "At that point it will become full legal tender and all payment processes will have to accept it as legal tender, so it will achieve legal status in China," says Michael Sung, chairman at CarbonBlue Innovations and professor at Fudan University.

Despite different parts of the world being at very different stages of the CBDC lifecycle, the challenges they face remain the same. One of the key concerns surrounding CBDCs is data privacy.

"Privacy is extremely important and in the US it is something we value tremendously, so any CBDC that wants to gain traction is going to have to grapple with privacy concerns"

– Hester Peirce, commissioner at the SEC.

Culture and data privacy

On April 14 2021, the European Central Bank (ECB) published its public consultation on the digital euro where they found that respondents cited privacy and data issues as the key concern. Privacy was the top priority for 43% of both professional and public respondents.

Markus Ferber, member of the European Parliament, states that: "Ensuring the privacy of the users of a digital euro while still having robust anti-money laundering (AML) provisions in place, will be no easy feat." His opinion is widely shared.

"We know that trust is an issue, some people don't trust that the government or banks are monitoring CBDCs," says Teunis Brosens, head economist of digital finance and regulation at ING.

"Suggestions have been made that one way to approach this is to implement full privacy for small transactions and enable transaction monitoring for larger transactions," adds Brosens. "There is this trade-off, but it is doable."

Similarly, in the US, ensuring data privacy and protection is at the top of the regulatory agenda when it comes to issuing a CBDC.

"Privacy is extremely important and in the US it is something we value tremendously, so any CBDC that wants to gain traction is going to have to grapple with privacy concerns," says Hester Peirce, commissioner at the US Securities and Exchange Commission.

In the US, the Federal Reserve has plans to release its own CBDC, which is separate from the privately led effort of the Digital Dollar Project, but it is only in the exploratory phases of a digital dollar.

In May 2021, Federal Reserve chair Jerome Powell announced that the Federal Reserve will release a research paper this summer that explores issues with releasing a CBDC. Several other Federal Reserve districts are involved in research of their own – for instance, the Federal Reserve Bank of Boston and MIT have launched a joint project experimenting with a hypothetical model of a CBDC.

"In a digital currency, privacy is a design choice, if designed correctly and in keeping with our constitutional law," says Giancarlo. "With the US digital dollar, we can design into it privacy from both government and commercial surveillance, except for where appropriate for law enforcement activities."

People in western countries are arguably more concerned with ensuring a balance of data privacy and protection with AML regulations.

One expert on CBDCs in the US, who chose to remain anonymous, says that "people here do not take the Chinese project that seriously."

"Everybody understands that in China nobody has any privacy and the government spies on everybody all the time," he adds. "So substituting WeChat or Alipay for a government one isn't much of a leap over there."

However, other sources believe that complete data privacy and AML compliance cannot go hand in hand.

"Few people in the west fully understand how surveilled their financial transactions are currently," says Caitlin Long, founder and CEO at Avanti Financial Group. "A CBDC doesn't change our level of privacy. Financial surveillance has been increasingly ramped up since 9/11. No financial transactions are truly private."

In the world's second largest economy, the illusion of privacy is more widely accepted as just that – an illusion. "People live in a world where we have the illusion of privacy, they believe that their transactions are private, but they really aren't," says Richard Turrin, a fintech consultant who authored *Cashless, China's Digital Currency Revolution*. "They are open to governments and different people."

However, this does not mean that data privacy laws are not in place in China. "China actually has very strict digital privacy laws, it attempts to give data to only those who need it," he adds.

Digital coins have a transaction history embedded into the blockchain. The ability to see into that data is very limited by the rules of digital privacy in China. For example, regulators will only allow a bank to see who last used it before it re-entered the bank system.

"The People's Bank of China (PBOC) has the complete ability to decrypt and understand who had what; and people in the west have been highly critical that the bank could limit or otherwise restrict access," says Turrin.

He continues: "What fearmongers fail to acknowledge is that the PBOC currently has access to the data of WeChat and Alipay, which are the two leading digital platforms. The PBOC, other than for criminal activity, have not disrupted payments."

"I understand that people are wary of China," adds Turrin. "But if they aren't exercising these powers with WeChat and Alipay, why would they suddenly start to use them maliciously with CBDCs? That comparison is frankly never made."

The PBOC has explicitly stated that the digital yuan will be pseudo-anonymous, meaning that there is a degree of privacy afforded. The central government is not going to monitor every micro-transaction but will investigate transactions that flag up AML or illicit compliance concerns.

This is not a phenomenon unique to China. In both Europe and the US, transactions exceeding a certain amount will also be flagged up and surveilled. The digital yuan system has been designed to balance user privacy with proper regulatory AML compliance checks at the gateways into the ecosystem, much as is the case in the traditional banking world (i.e. inbound bank transfers).

Depending on the amount transferred to the digital wallet, varying level of know your client (KYC) requirements apply (e.g. small amounts can be unlocked through online means, larger amounts may require a trip to the bank to provide the necessary documentation).

"The system has been designed to be pseudo-anonymous, i.e. these regulatory checks are done at the gateways into the system, but thereafter transactions between wallets are encrypted and not monitored," says Sung of CarbonBlue Innovations.

"In fact, a wallet can directly transfer e-CNY to another wallet through near field communication technology without the presence of internet," he continues. "In such cases the government has absolutely no way to track such transactions."

This system is one that most countries are likely to adopt.

Francisco Uria, global head of banking and capital markets at KPMG, agrees with this notion. "In the end, we are going to need some kind of agreement on what level of privacy is going to be allowed without creating a problem on the AML side," he says.

"With that reason my guess is that the digital euro isn't going to be so pure in terms of lack of traceability or so radically different from the Chinese model," he adds. "For AML purposes, some levels of control – as already exists with cash – should be implemented."

The need for some level of interoperability between the future CBDCs is also a factor to be considered, says Uria.

Interoperability and political forces

To fully harness the effectiveness of CBDCs, especially when it comes to cross-border payments, a system of interoperability needs to take form, allowing currencies of different countries to digitally cooperate. However, competing central bank priorities and current geopolitical forces will bring complications.

"The concept that digital currencies will all sit around the campfire and sing Kumbaya is deluded"

– Richard Turrin, fintech consultant

"Interoperability will be a key issue and there will be political dimensions to working out those global stamps," says Giancarlo. "The US needs to work closely with other countries regarding this issue and establish protocols for how interoperability standards will be determined."

The UAE, Thailand, Hong Kong SAR and China, are currently under way in testing out a system of CBDC interoperability with Project Inthanon-LionRock, which was recently renamed the m-CBDC Bridge Project. The project aims to create a proof-of-concept prototype of real-time cross-border foreign exchange payment-versus-payment transactions in a multi-jurisdictional context, using the capabilities of distributed ledger technology.

Despite these initiatives, interoperability remains in its very early stages for much of the world.

Sung likens interoperability systems today to what the internet was 20 years ago. "At first financial institutions didn't believe in the internet, it was too wild wild west, so everybody created their own internets," he says. "It was only when these internets started to communicate with each other that you could see the true power of the digital economy."

This is similar to what is currently happening with CBDCs. "Everyone, from central banks to private stablecoin issuers, is now rushing to implement digital currencies on different blockchain ecosystems, including Hyperledger, Corda, Ethereum, Tezos, Algorand, Solan or Stellar, to name a few," says Sung.

Right now, the key limiting factors are technology and regulatory interoperability.

"Only when these systems can start to talk to one another in a compliant way across jurisdictions will the true impact of digital currencies be felt, in terms of disrupting the existing international monetary system," Sung adds.

There have been a number of protocols issued on interoperability. A notable one is Polkadot in China, which connects multiple blockchains into one network. However, "it is likely that governments will eventually agree on some form of interoperability through multilateral organisations," says Avanti's Long.

"This is how SWIFT [a global banking payment protocol] came about in the first place," she adds.

In October 2020, the BIS, in conjunction with seven central banks, published a report outlining common foundational principles and core features of future digital currencies required for a workable CBDC system.

Sung agrees with the notion that multilateral agencies will take the lead in setting out regulation for interoperability. "We have all sorts of quasi-NGOs and sovereign organisations weighing in on this issue, the Financial Action Task Force (FATF) for example has issued guidelines for what they call the 'travel rule'."

The travel rule states that if a digital asset transfer occurs between ecosystems from wallet to wallet or blockchain to blockchain, then the digital asset needs to have meta data that identifies the historical record of who is transmitting the digital assets to travel along with the digital assets, in order to facilitate compliance checking.

"This is a major deal because in the crypto decentralised world there are no regulations," says Sung. "That is one of the benefits of a decentralised ecosystem, you can do an anonymous transfer without this KYC hassle. However, the FATF guidelines are very rough and open to interpretation – so this needs to be streamlined."

Of course, different countries and state blocs are at very different points in the process.

Singapore, for example, is currently testing out its own system of interoperability between public and private institutions. The Monetary Authority of Singapore (MAS) announced in September 2020 that eligible non-bank financial institutions (NFIs) will have direct access to the banking system's retail payments infrastructure from February 2021.

"This continues to be an area of study," says a spokesperson at MAS. "Minimally, the underlying platform must ensure interoperability among payment and settlement systems and demonstrate flexibility in architecture to allow for easy incorporation of new developments, such as advances in the private provision of payment services."

Singapore is already currently under way with Project Ubin, an industry-led effort by MAS to explore the use of blockchain technology and a CBDC issued by MAS to clear and settle payments and securities more efficiently.

"Rather than comparing efforts, multilateral connectivity and collaboration is needed to enhance cross-border payments," says the MAS spokesperson. "By collaborating, central banks will be able to avoid duplication of efforts and ensure the interoperability of next generation cross-border payments and settlement infrastructure."

Europe and Japan have been testing an early-stage form of interoperability. Known as Project Stella, the ECB and the Bank of Japan are conducting a study that harnesses the concept of distributed ledger technology and is looking to lay the groundwork for future digital currencies.

"What is needed is a common regulatory language to aid the challenge of interoperability given the number and diversity of different payment systems, both domestically and internationally," says Alexandra Foster, director of insurance, wealth management and financial services at British Telecom.

"A solution could either be one of the current standards like ISO 20022, or a new common standard," she adds. "The infrastructure and any interoperable participants in a CBDC system would need to be resistant to cyber-attacks and other potential threats, with an emphasis placed upon operational resiliency."

Systems of interoperability will likely be built around current geopolitical forces. "It's impossible to separate CBDC from geopolitics," says Simon Taylor, venture director and co-founder of 11:FS. "For China domestically it's about reining in the tech giants, and globally about being able to have more economic and trade impact without reliance on the US dollar."

Popular discourse in the west has been that the digital yuan was created to challenge the hegemony of the US dollar.

An expert in the US on CBDCs says: "I don't think anybody really believes that China will have great success with people adopting a digital yuan as a global currency – no one wants the Chinese government spying on you or turning you off at any moment."

Project sand dollar

Among the very first retail CBDCs to proceed to public implementation is the sand dollar issued by the Central Bank of the Bahamas (CBOB). This digital version of the Bahamian dollar went live for public use on December 27 2019, and consumers, merchants, banks and other financial institutions, even street vendors, have begun transacting in sand dollars. For the Bahamas, the introduction of sand dollars is a continuation of the Bahamian Payments System Modernization Initiative (PSMI), which began in the early 2000s.

The Bahamian PSMI seeks to improve outcomes for financial inclusion and access, increasing the efficiency of payment systems, as well as to foster greater participation in the financial services market by non-traditional providers such as fintech companies.

CBOB ran a competitive public tender process and selected NZIA Limited as its exclusive technology partner to architect and develop the sand dollar system. The resulting software/hardware hybrid architecture of sand dollar provides for an extremely robust system that features high system availability, ledger immutability, superior security, ease of use and high transaction speeds.

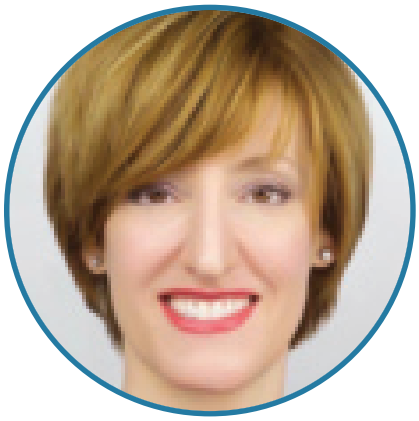
The blockchain underpinning sand dollar is private and permissioned and does not suffer from the scalability and speed issues that can plague public, open-source blockchain systems like bitcoin and ethereum. The system has multiple redundancies and leverages edge computing capabilities to provide localised access to sand dollars from remote places even with the loss of internet access.

The sand dollar is designed to be extensible and avoid disruption to the existing financial infrastructure, with protocols and development kits being made available to financial institutions and fintech companies to allow for easy integration. Since KYC/AML considerations must be observed, the anonymity of cash is not being completely replicated, although the sand dollar infrastructure incorporates a number of cutting-edge confidentiality and data protection safeguards to balance the interests of privacy and regulatory supervision. This is an important feature. Without such protections there is a risk that the confidence required for population-wide adoption of the digital currency could be undermined.

The CBOB and the Bahamian government are keen to achieve a number of measurable outcomes through the introduction of sand dollars in the economy, such as providing universal access to banking and digital payment services, reducing the volume of "unrecorded" economic activities that take place using physical cash, and helping bring all legacy businesses into the digital space.

In particular, a risk-based, multi-tiered KYC regime is being applied to onboard the unbanked to the sand dollar system, which should boost inclusion in the mainstream financial system and eventually result in credit generation. Sand dollar, through its traceability features, is expected to strengthen regulatory capabilities against money laundering and other illicit activities, as well as helping realise efficiencies in the government's expenditure and tax administration systems.

By John C.H. Kim and Andrew Lom of Norton Rose Fulbright



"Few people in the west fully understand how surveilled their financial transactions are currently, a CBDC doesn't change our level of privacy"

– Caitlin Long, founder and CEO at Avanti Financial Group.

The source adds: "I just don't see who in their right mind would want to use it as the global reserve currency."

However, experts in China disagree with statements like these. "The digital yuan will overthrow the hegemony of the US dollar – I think those sensational statements are way overhyped," says Sung. "Money is already digitised, so a new form of this isn't that radical. It is also very localised within China, at least for the first phase."

Fintech consultant Turrin adds: "The concept that digital currencies will all sit around the campfire and sing *Kumbaya* is deluded."

This sentiment is echoed by Irina Heaver, a private crypto consultant based in Dubai and Switzerland. "CBDCs will shake up the political makeup of the world and the status quo of the western world."

She adds: "It will build new alliances, for example Thailand, Hong Kong, China and UAE – that's quite an unlikely alliance. Why would they set up this payment gateway? Surely something is lurking in the background in terms of trade alliances."

Legal status

Issues of data privacy and interoperability aside, one further regulatory concern when it comes to CBDCs is whether they will fall under the same legal status as a fiat currency or if they are classed in the cryptocurrency camp.

"In mainland China, both physical and digital forms of RMB will be recognised by statute," says Urszula McCormack, partner at King & Wood Mallesons. "This means e-CNY will have the same legal status as other forms of RMB, with one to one convertibility."

This statutory recognition is important – there are multiple regulatory impacts that flow from the legal treatment of a CBDC as currency versus debt, stored value, a derivative or a virtual asset.

"But we have to remember that this relates to recognition in China," she continues. "It is critical to look at offshore regulatory regimes to work out how assets and related services are regulated, and how a person might practically and legally gain access to e-CNY from offshore."

Giving the digital yuan the same legal status as the fiat currency is how both the digital dollar and the digital euro will work.

"At the moment, all the characteristic of the digital euro are going to be absolutely the same as the euro," says Uria at KPMG. "However, when the European Commission talks about issuing a digital euro in five years, it is too long. We will see it sooner than that, as there is competition between CBDCs and other stablecoins to be used as a reference in global trade."

Sources suggest that it is crucial that CBDCs closely resemble the currencies on which they are based.

"The holder of the digital dollar should hold the same value as a holder in the fiat currency," says Giancarlo. "It is a digital token representing the dollar. It isn't an account base dollar and it is not an issuance of a bank. It is an issuance of a central bank."

One of the key goals of a CBDC is financial inclusion, which is where its legal status comes into play. An example of this is the sand dollar, which is the official CBDC of the Bahamas and the most advanced one in the world.

"The Bahamas has citizens across thousands of islands with no access to bank services but access to mobile devices," says Giancarlo.

The sand dollar has helped to strengthen the payment infrastructure, providing accessibility to all residents of the archipelago in a non-discriminatory way. It has also aided digital commerce, in turn improving the economy.

"The objective is to include as many people into the economic and financial system; but the question is why?" asks David Lee Kuo Chuen, professor at the Singapore University of Social Sciences. "It's quite straightforward. We have come to a situation where 1% of the population owns more than 50% of the assets of this world."

Lee gives the example of Satoshi Nakamoto, the name given to the founder of bitcoin. "If he had continued to mine bitcoin only for him and his friends, the value of the currency would still be at $2 or $3."

"Satoshi diminished himself and after mining two million as a fire starter, built the infrastructure and left it to the public to benefit from the system," Lee adds. "Looking at that model of inclusivity you wouldn't be surprised that the value of bitcoin is now hovering around $40,000."

One of the ultimate goals of CBDCs is financial inclusion. To achieve this, CBDCs have some way to go – but the wheels are in motion.

Collective R&D investment is vital to enhance national security

In this edition of his national security column, Berkeley Research Group's Harry Broadman discusses the steps the G7 and other advanced democracies should take to engage collaboratively in R&D to protect their collective economic fortunes

Front and center on the agenda of the annual meeting of G7 – the globe's most powerful democracies – this summer in the UK, is bolstering their national security as the technological prowess of China – country whose autocratic leader embraces communist economic policies ever tighter – marches on. Attempts to unify on this front has been a long-standing challenge for the G7, which continues to be exacerbated by fissures among the members about the lure of cozying up to the world's second largest market.

Over more than three-quarters of the last century, the G7 countries (along with the other advanced democracies) have built a mature web of sovereign-to-sovereign agreements governing their cross-border investment and trade flows as a pathway toward boosting their collective economic fortunes. Paradoxically, by comparison there is sparse systematic collaboration among them on technological advancement through research and development (R&D), the third of the three-legs of nations' international competitiveness.

Indeed, the lion's share of advanced democracies' sovereign-to-sovereign science and technology (S&T) agreements is grounded in the pursuit of "science diplomacy" rather than in fostering the commercial application of R&D. Moreover, many of these agreements are structured on a bilateral, as opposed to a multilateral or plurilateral, basis, like many of their trade and investment accords.

With these characteristics, it is hard to imagine the existence of a robust ecosystem that can nurture the type of collective action by the G7 and like-minded countries they would like to take to counter China and enhance their national security.

How we got here

There always has been heterogeneity among the G7 in terms of each nation-state's S&T policies and their R&D enterprise – the market and institutional structure of the way

"Indeed, the Chinese are exploiting the differences among the G7 in their R&D architecture"

in which national labs, corporations, and universities interact; the mechanisms for commercialisation of innovations; and national business cultures and norms.

In recent years, however, some of these differences, have become not only more evident, but are also exposing these states to risks of being unable to compete effectively in the global economy and of eroding their national security.

This turn of events stems from the fact that, like much of the rest of the world, the economic fortunes of the G7 increasingly have become tethered to China. Indeed, the Chinese are exploiting the differences among the G7 in their R&D architecture.

The current substantial network of sovereign-to-sovereign S&T agreements between the G7 and other advanced democracies does engender collaboration among scientists, though largely, but not exclusively, from academia and government. This is because the role of corporates in R&D activities in the domestic sphere differs greatly across these countries. Whereas in Europe, businesses collaborate extensively with universities, in the US such relationships are rare.

This is why in the international arena, sovereign-to-sovereign S&T agreements are characterised as "science diplomacy." Indeed, this is the term conventionally utilised by negotiators of such agreements. Its use encapsulates much of what is wrong with this enterprise: it accurately reflects the substance and objectives of the agreements negotiated. And, it certainly does not signal to would-be adversaries that the signatories are serious about mitigating the technological risks to their national security.

I know this first-hand. Earlier in my career, as US assistant trade representative, among my other responsibilities of leading US negotiations of international trade agreements and international Bilateral Investment Treaties (BITs) as well as serving as a member of the Committee on Foreign Investment in the United States (CFIUS), I also co-led US negotiations of international S&T agreements with a cohort from the US department of state. Other than my agency, which sat (and still does sit) within the executive office of the president, other agencies, especially those with focused missions in the economic, science and technology and defense spheres, were not heavily involved.

Mind you, that was the era when Japan was seen by the US and other countries as the technological threat to national security. Flash forward to today, where it is China not Japan in the cross-hairs.

Much of the current debate swirling about the undue concentration of advanced countries' production located in, or supply chains emanating from, China is focused on the wisdom of, or even the ability for, instituting government-mandates to force foreign companies to decouple from the country, which is increasingly referred to as the world's factory.

Putting aside the dearth of understanding by proponents of decoupling about how foreign firms operating in China actually function, at its core, the pursued objective is one of *defense*, not *offense*. In addition, their focus is centered more on incumbent or legacy products, processes and technologies than on R&D investments that will not only drive the next generation but also enhance firms' ability to enhance the value capture of such investments.

It is the latter area on which fresh collective efforts for devising international sovereign-to-sovereign agreements to coordinate R&D investment activities among the advanced democracies must focus and do so in a proactive mode.

What should be done

The process of negotiating and evaluating outcomes of international S&T agreements is significantly different from that of negotiating international trade agreements and investment treaties (especially so in the US). The former is not nearly as inclusive or systematic with respect to involving external stakeholders as the two latter regimes.

For trade and investment agreements there is an elaborate – and remarkably efficient –superstructure in which business, labour unions, and NGOs (environmental groups, research entities, think tanks, and universities) are routinely and extensively involved both in the front-end of negotiations as well as at the evaluation stage. In the case of international S&T agreements, these elements of stakeholder participation rarely exist as standard practice.

To the uninitiated, bringing together stakeholders for such activities may seem to be unduly process-oriented. For international trade and investment

"At the bedrock of international trade agreements and investment treaties are two long-standing principles: reciprocity and national treatment"

agreements it is not: the focus is often extraordinarily keyed to defining not only which tangible goals and outcomes should be sought (think, lowering specific tariffs or opening up certain sectors for foreign investment), but also how should negotiators go about seeking them (think, where is there the most leverage and on what specific foreign products or service markets do domestic constituencies place the highest value). There should be no shortage of defining analogous elements in the case of S&T agreements. The current practice of international scientific data-sharing arrangements is an important example in this regard.

Moreover, in the case of international trade and investment agreements, the process is often cleverly used as a way to help achieve national consensus about salient policy parameters.

Epitomising this is the fashioning of model agreements, which serve as the starting point for international negotiations with other sovereigns. The most obvious example is the process of crafting a country's model BIT (which is done every several years). This, too, can be a lesson for modernising the regime governing international S&T agreements.

At the bedrock of international trade agreements and investment treaties are two long-standing principles: reciprocity and national treatment. Adherence to these strictures by participating sovereigns is the *sine qua non* of international trade and investment agreements. They are what makes such agreements so meaningful, so much so that violations lie at the core of cross-country trade and investment disputes.

Relatively few international S&T agreements embody such terms; and for those that do, the provisions are largely viewed as lip-service. Not surprisingly, little if any enforcement of S&T agreements is carried out; indeed, there do not exist meaningful disciplines embodied in such agreements with which to exact remedies when there are violations or disputes. Without such strictures, international cooperation in commercially oriented, precompetitive R&D activity among sovereigns will not be meaningful.

Concrete next steps

There is a powerful message here: there is only a nominal focus (and sometimes none at all) on like-minded countries collectively advancing pre-competitive, commercially-oriented objectives that harness the application of the fruits of these international S&T agreements – objectives that if fulfilled can enhance economic growth, international competitiveness and national security of participating countries.

Rather, those types of goals are, for the most part, still pursued by the G7 and other advanced democracies individually. The result? Missing the ability to capitalise on important S&T opportunities that could significantly enlarge economic advances *for* all, over and above what can be accomplished at the individual country level.

At present such objectives are only sought by countries where there are strong pre-existing institutions structured at the multi-country level focused on advancing economic growth, most notably common approaches to boosting cross-country trade and investment flows.

This speaks to the importance for advanced democracies interested in boosting S&T cooperation to do so in ways that dovetail with fulfilling their collective economic objectives with respect to trade and investment – especially in enhancing and re-orientating the location of value capture. In fact, while the three regimes of international agreements interact with one another in shaping the stance and composition of countries' industrial and national security policies, such linkages are rarely made explicit.

Moving forward, this is why a key item on the G7's agenda should be the development of mechanisms to better drive such interactions and mitigate risks to their national security, such as the HYPERLINK "https://www.fdiintelligence.com/article/79412" establishment of a standing G7 working group—the R&D7 – similar to other G7 working groups focused on other important issues.

Harry Broadman
Berkeley Research Group

Hong Kong SAR cross-border insolvency landscape evolves for Chinese corporates

Naomi Moore, Daniel Cohen and Jeremy Haywood of Akin Gump explain the implications of recent Hong Kong SAR court rulings on cross-border insolvency cases concerning HKEX-listed mainland Chinese corporate groups

The Hong Kong Companies Court has made a number of rulings concerning mainland Chinese corporate groups listed in Hong Kong SAR which illustrate the evolving landscape of cross-border insolvency law. These cases may, in some instances, cause creditors and debtors to re-evaluate some of the enforcement and defensive strategies traditionally used in the insolvencies of such companies.

The Hong Kong Companies Court has made a number of rulings concerning mainland Chinese corporate groups listed in Hong Kong SAR which illustrate the evolving landscape of cross-border insolvency law. These cases may, in some instances, cause creditors and debtors to re-evaluate some of the enforcement and defensive strategies traditionally used in the insolvencies of such companies.

Hong Kong SAR has long been an international finance centre and investment gateway for mainland China. Not surprisingly, there are a significant number of mainland Chinese corporate groups listed on the Stock Exchange of Hong Kong (HKEX). As of December 31, 2020, there were 1,319 mainland enterprises listed on the HKEX, comprising 52% of the total number of listed companies and 80% of the total market capitalisation.

Many of these listed companies are incorporated in offshore jurisdictions such as the Cayman Islands, the British Virgin Islands or Bermuda and have issued substantial amounts of foreign law governed debt (often New York law governed bonds). Most have their principal operations in mainland China. In the context of an insolvency scenario, these group structures often spawn many complex cross-border issues which need to be solved.

The utility of winding up proceedings in Hong Kong SAR

Hong Kong SAR, as the place of a mainland Chinese group's listing and given its proximity to the mainland, is

often a jurisdiction of focus for creditors of a mainland Chinese corporate group in a default and enforcement scenario. The primary enforcement tool available in Hong Kong SAR to unsecured creditors of an insolvent company is a winding-up petition which, if successful, will result in the appointment of liquidators to take control of, and realise, the assets of the company.

As a starting point, a foreign-incorporated HKEX-listed company is capable of being wound up in Hong Kong SAR provided that the following three core requirements can be satisfied: (i) the company has a sufficient connection with Hong Kong SAR, but not necessarily consisting of the presence of assets in the jurisdiction; (ii) there is a real possibility that the winding-up order would benefit those applying for it; and (iii) the Court is able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

However, while the first and third core requirements are usually satisfied if a company has a listing in Hong Kong SAR, the Hong Kong Companies Court in Re China Huiyuan Juice Group Ltd expressed significant doubt about whether the same is true of the second core requirement.

In that case, the debtor company was insolvent and the value of its listing (once realised) was thought to be questionable. The Court observed that the value of listings in Hong Kong SAR seemed to have dropped to approximately the cost of a conventional restructuring. Accordingly, the Court said that it would require evidence to demonstrate a real (not hypothetical) prospect of a material financial benefit to creditors from the realisation of a listing in order to satisfy the second core requirement.

This may not always be required. In the earlier case of Shandong Chenming Paper Holdings Limited v. Arjowiggins HKK2 Limited, the Court found that the second core requirement was satisfied by reason of the listing in Hong Kong SAR. The Court was of the view that the company had refused to pay the debt in question out of intransigence, so that the pressure of a liquidation – and the threat to the listing – were likely to provide the petitioner with leverage and force payment.

Nevertheless, it appears that going forward the Hong Kong SAR Courts will apply closer scrutiny to the economic and strategic value of the listing in assessing whether the three core requirements have been met.

Offshore provisional liquidation as a debtor response

A common strategic approach for offshore-incorporated HKEX-listed companies faced with a local winding-up petition in Hong Kong SAR is to take defensive action in the company's place of incorporation.

This usually takes the form of a "soft-touch" provisional liquidation application in the offshore jurisdiction. Soft-touch provisional liquidation is a restructuring tool that allows a company to remain under the day-to-day control of the directors but with the protection from actions by individual creditors afforded by the provisional liquidation process. Upon the appointment of soft-touch provisional liquidators over the company for the purposes of facilitating a financial restructuring, the provisional liquidators are then able to seek recognition and assistance at common law in Hong

Kong SAR, including a stay of any existing local winding-up proceedings.

The effect of any such stay would essentially be to subordinate the Hong Kong SAR winding-up proceedings to the soft-touch provisional liquidation in the company's place of incorporation.

For context, Hong Kong SAR does not have a statutory cross-border insolvency and restructuring recognition and assistance regime. In lieu of one, the Hong Kong Court has developed and expanded a common law framework for cross-border recognition and assistance. Since the landmark decision of Joint Official Liquidators of A Co v B, common law recognition applications have become commonplace in Hong Kong SAR with recognition so far having been granted by the Court in respect of foreign insolvency proceedings commenced in Australia, Bermuda, the Cayman Islands, the British Virgin Islands, Japan and mainland China.

The applicable principles are as follows:

1. The Court may recognise a foreign collective insolvency proceeding (including a voluntary liquidation). So far, this has been limited to 'collective' insolvency proceedings commenced in a company's place of incorporation. However, the Court has recently observed that there is no doctrinal reason why the common law in Hong Kong SAR could not extend to the recognition of insolvency proceedings in a company's centre of main interests (COMI), which is not the jurisdiction of incorporation.
2. The Court may then grant assistance in Hong Kong SAR to the relevant overseas insolvency officeholders appointed in the context of the recognised proceeding.
3. Such assistance may extend only to what is necessary in the performance of the overseas officeholder's functions. It cannot enable the officeholder to do something that he or she could not do under the law by which he/she was appointed.

The recent decision in Re FDG Electric Vehicles Limited called into question a debtor's defensive and tactical use of an offshore soft-touch provisional liquidation in response to a creditor's winding-up petition in Hong Kong SAR.

In FDG Electric Vehicles, the Hong Kong Companies Court was asked to recognise and grant assistance, including by way of a general stay of proceedings in Hong Kong SAR, to the provisional liquidators of a Bermuda-incorporated Hong Kong SAR-listed company.

In recognising the provisional liquidators and granting a modified form of assistance from that originally sought, the Court held that, while it is well established that the Court in Hong Kong SAR has the power to assist foreign liquidators by ordering a stay of proceedings in Hong Kong SAR under the doctrine of modified universalism, this power only existed to aid foreign collective insolvency proceedings.

As soft-touch provisional liquidators are typically appointed to facilitate the restructuring of a company's debts (rather than for the purpose of collecting in a company's assets and distributing them to its creditors under a single system of distribution), the Court held that it was not yet accepted that a soft-touch provisional liquidation was for all purposes to be treated as a collective insolvency proceeding.

Moreover, where the debt the subject of a creditor's winding-up petition is governed by Hong Kong SAR law, then the 'Gibbs rule' is relevant. This provides that the discharge or compromise of liabilities under a contract is to be governed by the laws of that contract. The Court observed that a stay of local proceedings in aid of a foreign insolvency proceeding should not be granted in respect of proceedings in Hong Kong SAR to establish a right of payment under a contract governed by the laws of Hong Kong SAR.

Consequently, with the above points in mind, the Hong Kong Companies Court signalled a new direction in FDG Electric Vehicles. Rather than provide for an automatic, general stay of all Court proceedings in Hong Kong SAR (which had been the norm before the FDG decision), the standard recognition and assistance order in the future would enable an offshore-appointed soft-touch provisional liquidator to apply separately for a stay or other directions in respect of a particular set of proceedings (including a winding-up petition). In other words, no general stay. This would give the parties impacted by a stay of particular proceedings (e.g. a creditor petitioner) an opportunity to seek to resist this outcome.

Further scrutiny of tactical soft-touch provisional liquidation

FDG Electric Vehicles did not address the broader and highly important matter of which insolvency process is to be afforded primacy where a creditor petitions the Court in Hong Kong SAR for the winding-up of an HKEX-listed offshore-incorporated company, which is also subject to soft-touch provisional liquidation proceedings commenced defensively by the debtor in its place of incorporation.

This question was addressed in the subsequent Hong Kong SAR decision of Re Lamtex.

The facts involved a creditor's winding-up petition in Hong Kong SAR in respect of a Bermuda-incorporated HKEX-listed company. Following the presentation of the Hong Kong SAR petition, the debtor applied to appoint soft-touch provisional liquidators in Bermuda. Once appointed, the provisional liquidators then sought recognition and assistance in Hong Kong SAR and an adjournment of the Hong Kong SAR petition to give the company breathing room to progress a restructuring. This tactical manoeuvre failed.

The common law doctrine of 'modified universalism' guides the Hong Kong SAR Court when determining cross-border issues arising in transnational insolvencies, such as a request for recognition and assistance of a foreign insolvency officeholder. The application of this doctrine in Hong Kong SAR had traditionally afforded primacy to the company's place of incorporation in situations where there were competing foreign and local insolvency proceedings.

The question for the Court in Re Lamtex (and in the context of another case, Re Ping An Securities Group, which was decided around the same time) was whether this approach required the Hong Kong SAR winding-up petition to be adjourned so that a restructuring could be pursued under the Bermudan soft-touch provisional liquidation.

The Court held that in a contest for primacy between insolvency proceedings opened in the jurisdiction of incorporation (i.e. Bermuda) and in the company's COMI, which was Hong Kong SAR, on the facts of Re Lamtex, there was less reason to give primacy to the place of incorporation than had been the practice historically. In particular, the Court observed that local Hong Kong SAR proceedings should not be stayed in favour of a foreign proceeding if the foreign proceeding comprises a soft-touch provisional liquidation being managed out of Hong Kong SAR and used to circumvent the problems created by the absence in Hong Kong SAR of a formal corporate rescue procedure.

The Court also observed that, if the three core requirements for the winding up a foreign company in Hong Kong SAR are satisfied then, "it is not…sufficient for the Company simply to point to insolvency proceedings commenced sometime after the Hong Kong Petition was presented in its place of incorporation and request in the face of objection from local creditors this court simply to defer to that of the place of incorporation. It seems to me unrealistic to expect the court not to have regard to the fact that companies such as the present conduct business in the People's Republic of China which commonly is also the location of a high proportion of their shareholders, creditors and assets."

In dealing with these issues moving forward, the Court proposed the following framework to address questions of primacy with respect to insolvency proceedings opened in different jurisdictions:

1. Generally, the place of incorporation should be the jurisdiction in which a company should be liquidated; in practice, this means it will be the system for distributions to creditors.
2. However, if the company's COMI is elsewhere, regard is to be had to other factors:
   a. Whether the company is a holding company and, if so, whether the group structure requires the place of incorporation to be the primary jurisdiction in order effectively to liquidate or restructure the group
   b. The extent to which giving primacy to the place of incorporation is artificial having regard to the strength of the COMI's connection with its location
   c. The views of creditors

What's next on the horizon in an evolving landscape?

These recent decisions illuminate a number of the cross-border challenges and complexities that arise in the insolvency of HKEX-listed mainland Chinese corporate groups and indicate that the Hong Kong SAR Court is beginning to adapt its approach to navigating some of these key issues. Evolution in this area will no doubt continue if the framework between mainland China and Hong Kong SAR on cross-border cooperation in corporate insolvency matters, which is currently being discussed, comes into play.

Similarly, if Hong Kong SAR's long awaited corporate rescue (provisional supervision) regime finally becomes law this year, as was the last indication from the Hong Kong SAR government in November 2020, it will give debtors a new strategic option in the tool kit and the Hong Kong SAR Court a new set of issues and complexities to navigate.

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Revision of Swiss company law and its effects on Swiss tax law

Lukas Scherer and Manuel Vogler of Prager Dreifuss consider the revision of Swiss company law and its impact on the Swiss tax landscape

In keeping with the saying 'good things take time', the Swiss Federal Assembly adopted the proposed revision of the Swiss company law on June 19 2020 – more than 12 years since its initial release. It is scheduled to enter into force on January 1 2022, at the earliest.

Scope of the revision

Among other things, the revision includes the following key topics:

- Introduction of important flexible rules with regard to share capital;
- Participation and control rights of shareholders;
- Liability under company law; and
- New provisions on business rescue.

This article deals with the planned innovations to the share capital and its effects on the Swiss tax landscape; especially the tax effects of the introduction of share capital in a foreign currency, the new instrument of the so-called 'capital band' and the introduction of the interim dividend.

Share capital in foreign currency

Under current law, the financial statements of a Swiss company can already be drawn up in the foreign currency most relevant to the company's business activities. Until now, however, this has not applied to the share capital.

According to the planned revision, the share capital may in future also be denominated in a foreign currency significant to the company from a business activity perspective. This means that capital-related aspects such as dividends, reserves and overindebtedness will also be assessed according to the relevant foreign currency.

It is envisaged that the permissible currencies will be Swiss francs, British pounds, euros, US dollars or Japanese yen. However, an 'all or nothing' principle applies, i.e. a mix of currencies is not possible. The cumulative requirements for the introduction of a share capital in a

1 MINUTE READ

In keeping with the saying 'good things take time', the Swiss Federal Assembly adopted the proposed revision of the Swiss company law on June 19 2020 – more than 12 years since its initial release. It is scheduled to enter into force on January 1 2022, at the earliest. What impact will the revision of Swiss company law have on the Swiss tax landscape?

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foreign currency can be summarised as follows:

- Foreign currency must be essential for the business activities in which the company operates (functional currency);
- Share capital in the foreign currency must correspond to an equivalent value of at least 100,000 Swiss francs at the time of incorporation or at the time the currency of the share capital changes;
- Accounting and financial reporting must be done in the same currency; and
- Foreign currency must be one of the following: Swiss francs, British pounds, euros, US dollars or Japanese yen.

The introduction of share capital in foreign currencies will be particularly interesting for companies whose accounts are already kept in a functional currency today and which operate in markets in which one of the recognised currencies is applicable.

Should existing companies wish to change the currency of their share capital at the beginning of a financial year, the general assembly must approve such motion with a qualified majority.

Subsequently, the board of directors is responsible for the implementation of the resolution of the general assembly. This entails the amendment of the articles of association once the board decides to change the currency and the board confirmation in a public deed that the above-mentioned requirements are fulfilled.

Corporate tax law consequences

Under current jurisprudence of the Swiss Federal Supreme Court, conversion differences between the applied functional currency and the Swiss franc merely indicate a potential risk and must therefore neither be shown positively nor negatively in the profit and loss statement. Rather, conversion differences must be shown as a neutral equity position without affecting profit or loss for tax purposes so far.

The proposed revision of the Swiss company law now clearly stipulates that the taxable net profit must be converted into Swiss francs at the applicable average exchange rate if the financial statement is denominated in a foreign currency. For income tax purposes, the average exchange rate applied to the tax period will be decisive.

With regard to capital tax, a conversion of the taxable equity capital will also be required in accordance with the revised tax law regulations, whereby the exchange rate at the end of the tax period will be decisive.

In summary, taxable profit and capital tax will be determined in a foreign currency in future. As a result, the aforementioned conversion differences between the functional currency and the Swiss franc should no longer arise, because all relevant tax factors will be determined on the basis of the chosen functional currency.

This approach goes hand-in-hand with the principle of equal treatment of the commercial accounting balance sheet as relevant tax basis. Ideally, the functional currency would therefore merely be converted into Swiss francs at the exchange rate at the end of the tax period in the context of the tax assessment. It is still unclear whether the tax return can be filed by using the functional currency or year-end numbers converted into Swiss francs.

Introduction of the 'capital band'

The introduction of the capital band aims to increase the flexibility of the capital regulations of companies. For this purpose, the board of directors will be authorised in the articles of association to increase or reduce the share capital by a quota of up to 50%, depending on necessity.

The capital band will be valid for a maximum period of five years. After this period, the basis for a new capital band would have to be created by amending the articles of association.

Once the revision comes into force, if a company makes use of the capital band it must include a provision in the articles of association authorising the board of directors to make use of the capital band when authorised to do so by a resolution of the general assembly.

Such resolution requires a two-third majority of the voting rights represented and a majority of the nominal value of the shares represented.

The authorisation provision must specify at least the highest and lowest limit of the capital band, whereby the upper limit of the capital band may not exceed the share capital

"The introduction of the capital band aims to increase the flexibility of the capital regulations of companies"

registered in the commercial register by more than 50% and the lower limit may not be less than 50% of the share capital. At no time may the capital band fall below CHF 100,000 (minimum capital requirement).

Furthermore, the articles of association must specify the date on which the authorisation to the board of directors expires. With regard to a reduction of share capital, the board of directors are only authorised to perform a reduction of share capital, provided the company has not opted-out from the requirement of a limited audit.

The board of directors decides within the scope of its authorisation on the increase or reduction of the share capital. Possible methods of increasing the share capital within the scope of the capital band are:

- An ordinary capital increase; or
- An increase from contingent capital, whereby the provisions on the ordinary share capital increase or the increase from contingent capital shall be applicable.

With regard to the reduction of the share capital within the scope of the capital band, the board of directors may use the instruments of:

- Ordinary capital reduction;
- Capital reduction in order to eliminate a capital loss; or
- Reduction of the share capital with a simultaneous share capital increase.

Additionally, the repurchase of own shares by the company will be of significance with respect to the capital band; especially with regards to tax questions.

Should the general assembly additionally agree on an ordinary share capital increase during the term of the capital band, the authorisation of the board of directors will cease and the capital band will have to be struck from the articles of association.

Furthermore, the general assembly may establish and/or adopt a contingent share capital within or outside the capital band. If the creation of such contingent share capital takes place outside the capital band, it will still have an impact on the capital band, since the higher and lower limits of the capital band are changed linearly in the case of a share capital increase from contingent capital.

All in all, with the introduction of the capital band, the general assembly can significantly broaden the board of directors' scope and flexibility in the light of equity financing as required.

Income tax consequences for private shareholders

The question arises whether the instrument of the capital band may trigger tax consequences for the company and/or the shareholders. For Swiss resident shareholders holding the shares as business assets, income tax consequences depend on the applied accounting method (i.e. whether changes in shareholdings are, or must be, recognised by changing the book value).

Swiss resident shareholders holding the shares as private assets do not have this possibility. In the following, reference is therefore only made to these shareholders.

Contributions by shareholders can be recognised at company level as special equity positions (so called 'capital contribution reserves'). Capital contribution reserves are not displayed in the commercial register.

From a tax perspective, distributions of capital contribution reserves are exempt from Swiss withholding tax irrespective of whether such distribution occurs to Swiss resident or foreign shareholders.

Further, for Swiss resident individuals holding the shares as private assets, distributions of capital contribution reserves are treated as a repayment of capital and are, hence, tax-free. Only contributions by the direct shareholders can qualify as capital contribution reserves. To be treated as such, the company must book the contributions in a separate equity position (capital contribution reserves) in its financial statement and the form 170 must be filed with the Swiss Federal Tax Administration (FTA).

For the sake of clarity, the filing obligation with the FTA applies to every decrease and increase of capital contribution reserves.

Issue

From an income tax perspective, it is envisaged that capital contributions within the framework of a capital band shall only qualify as capital contribution reserves to the extent they exceed the repayment of any free reserves within the capital band.

The assessment whether new or additional capital contribution reserves exist will therefore only be made upon termination of the capital band on a net basis: the contributions into capital contribution reserves must exceed the distributions of the capital contribution reserves during the period of existence of the capital band.

The legislator has made this adjustment in order to prevent listed companies from establishing capital contribution reserves for individuals resident in Switzerland who hold shares as private assets without any *de facto* restrictions (by setting up a separate trading line at the Swiss stock exchange SIX).

For individuals holding shares in non-listed companies as private assets, however, this change in the law has negative tax consequences in the event of a capital reduction. Since the FTA only confirms new capital contribution reserves upon termination of the capital band, there may be non-confirmed capital contribution reserves at the time of the capital reduction, which is why income tax consequences may not be averted for the shareholders concerned.

A possible solution to avoid this risk could be the purchase of treasury shares by the company.

Purchase of treasury shares

In the context of the purchase of own shares by a Swiss company (so called 'treasury shares'), certain potential tax pitfalls in relation to the so-called 'partial liquidation' need to be considered. The basic regulations are stipulated in Swiss corporate law: generally, the purchase of treasury shares up to 10% of the share capital is permitted; or up to a quota of 20%, if the shares are registered

> *"Issuance stamp duty will only be levied on the net increase of capital"*

shares with restricted transferability. In such case, 10% out of the 20% must be resold within a period of two years.

The purchase of treasury shares is only allowed, if the purchasing company has free reserves corresponding to the purchase value of the treasury shares.

From a tax viewpoint, a partial liquidation is given, if a company acquires treasury shares in connection with a resolution to reduce its capital. In this case, Swiss withholding tax is triggered and shareholders face income tax consequences due to the distribution of liquidation proceeds, unless the capital reduction is realised by a reduction of the capital contribution reserves.

Additionally, a partial liquidation applies, if:

- the quota of the acquired treasury shares exceeds the 10%/20% threshold;
- registered shares with restricted transferability are acquired and the shares exceeding the 10% quota are not resold or cancelled within two years; or
- the acquired treasury shares within the 10% quota are not resold or cancelled within six years.

In all these cases, Swiss withholding tax may be triggered and Swiss individuals holding shares as private assets could face income tax consequences.

The revision of the Swiss company law leaves room for discussion whether own shares can be purchased or resold within the capital band, or if a formal capital reduction or increase must be performed in each case. So far, Swiss legal doctrine tends to support the possibility of the purchase of treasury shares within the capital band.

From a tax perspective, the topic of the partial liquidation also applies to the purchase of treasury shares within the framework of the capital band. The capital band allows the increase or reduction of capital to a quota of up to 50%.

According to the revision of the Swiss company law, the lower limit of the capital band may be up to 50% below the registered share capital. However, it is currently unclear whether a capital decrease within the capital band of up to 50% below the registered share capital by way of purchase of treasury shares would lead to a direct partial liquidation because the 10% quota thresholds (or a quota of 20% in case of registered shares with restricted transferability) are *de facto* exceeded.

Some in Swiss legal doctrine have gone on record to suggest that treasury shares acquired within the capital band should not trigger immediate partial liquidation consequences if the portion exceeding the 10% threshold is resold or cancelled within two years.

The FTA has not yet made a final statement on this topic. If, however, the FTA does not confirm this doctrine, this would mean that the purchase of treasury shares within the capital band entail the Swiss withholding tax risk of a direct partial liquidation (and potential income tax consequences for private shareholders). This would run counter to the intended flexibility concept of the capital band.

Issuance stamp duty (*Emissionsabgabe*)

The planned amendments to the Federal Act on Stamp Duty provide that the issuance stamp duty on newly issued securities or capital increases within the scope of a capital band will only be due at the termination of the capital band and not at the moment of each capital increase.

Issuance stamp duty will only be levied on the net increase of capital. Consequently, no issuance tax stamp duty will become due if the capital increases do not exceed the repayments of capital within the same capital band. This solution was not envisaged in the first dispatch of the revision of the Swiss company law and was only included in response to concerns that the flexibility of the capital band should not be restricted by strict issuance stamp duty measures.

This relief is very much welcomed from a tax point of view as companies would have had little incentive to use a capital band if each capital increase would have incurred issuance stamp duties of 1%.

Interim dividends

Under current Swiss law, the distribution of interim dividends is not allowed. However, companies and entrepreneurs clearly expressed the need to allow for interim dividends, in particular for the sake of liquidity redistributions purposes and for companies whose (foreign) shareholders are used to receiving interim dividends.

The revision of the Swiss company law now expressly permits the payment of interim dividends. In case of an interim dividend distribution, the company has to prepare interim financial statements. It is, however, not necessary to include specific provisions on interim dividends in the articles of association.

The interim financial statements provide the board of directors with the necessary information including current and reliable figures on the course of business. The general assembly approves the interim financial statements, if necessary, and resolves the distribution of interim dividends.

For the sake of clarity, the revision of the Swiss company law does not prevent the annual general assembly to resolve on dividend distributions based on already approved financial statements (extraordinary dividends). Such distributions are not genuine interim dividends, but rather staggered distributions of balance sheet profit stemming from previous financial years.

All in all, the revision of the Swiss company law mainly facilitates interim dividends to be distributed intra-group by subsidiaries subject to audit obligations, which do not have sufficient free capital reserves or retained earnings from previous financial years.

From a tax point of view interim dividends are treated like ordinary dividends and are subject to withholding tax.

Conclusion

The entry into force of the revision of the Swiss company law will inevitably lead to tax changes.

Some ambiguities and irregularities, especially with regard to the capital band, currently still exist. These various open tax questions will hopefully be solved in a practical manner before the revision of the Swiss company law enters into force. It is yet to be decided how the practice will react to these challenges – the jury is still out.

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FATF and the future of decentralised finance

Lewis Cohen, co-founder of **DLx Law**, discusses the Financial Action Task Force's draft revised guidance on the recommended risk-based approach applicable to entities engaging in activities involving virtual assets

The Financial Action Task Force (FATF) is the international body that coordinates the development of international standards on combating money laundering and the financing of terrorism and proliferation of weapons of mass destruction. FATF implements these standards through a series of recommendations to national governments, who are ultimately responsible for their implementation.

On March 19 2021, FATF published a draft of its upcoming revised guidance (the draft guidance) on the recommended risk-based approach applicable to entities engaging in activities involving virtual assets (VAs), including traditional financial institutions, as well as entities considered virtual asset service providers (VASPs). The proposed revised recommendations in the draft guidance (the VA Recommendations) clarify FATF's most current recommendations contained in the final guidance on VAs and VASPs, which was published in June 2019 (the 2019 guidance). The draft guidance is currently open to public consultation and is expected to be published in final form in June 2021.

The 2019 guidance explicitly placed anti-money laundering and countering the financing of terrorism AML/CFT obligations on entities considered VASPs. However, the definition of VASP in the 2019 guidance was relatively narrow, focusing on those entities, such as centralised digital asset exchanges, with a custodial relationship with VAs on behalf of customers (i.e., knowledge of the private keys needed to move the VAs from one blockchain address to another).

It was also generally clear that providers of non-custodial software wallets (i.e., software that allow a user to control their private keys and interact with others without reliance on a third party), providers of multi-sig services (i.e., where a third party may control a "1 of n" private key to provide

"The most important aspect of the draft guidance is likely that it broadens the definition of VA and clarifies that the definition of VASP extends well beyond that suggested in the 2019 guidance"

added security to a user), software based "decentralised exchanges" (i.e., platforms that allow for the atomic or instantaneous exchange of one VA for another without the use of a third party), and other non-custodial services, were not considered VASPs.

The draft guidance significantly expands on the 2019 guidance in a number of ways, including:

- Providing guidance on how the VA Recommendations apply to what FATF refer to as "so-called stablecoins" (an intended swipe at the marketing of certain VAs);
- Providing additional guidance on the risks and potential risk mitigants for peer-to-peer transactions;
- Providing updated guidance on the licensing and registration of VASPs;
- Providing additional guidance for the public and private sectors on the implementation of the travel rule;
- Including principles of information-sharing and cooperation amongst VASP supervisors.

However, the most important aspect of the draft guidance is likely that it broadens the definition of VA and clarifies that the definition of VASP extends well beyond that suggested in the 2019 guidance. In particular, the draft guidance clarifies that both of these definitions are intended to be read expansively by national AML/KYC regulators and that there should not be a case under national financial regulations where a financial asset is not covered by the FATF Standards, either as a VA or as a traditional financial asset.

Decentralised finance

Squarely in the sights of draft guidance is the rapidly growing area of decentralised finance (DeFi). The term DeFi is used to refer to financial tools built on open (permissionless) blockchain-based networks, most notably Ethereum. These tools utilise VAs, such as bitcoin, ether, and other digital assets compatible with the ERC-20 standard, and do not involve the "custodying" of these assets by any individual or business. Instead, the relevant VAs are sent to the address of a smart contract (computer code stored on the relevant blockchain network) where the VAs will remain locked until the relevant code sends the assets elsewhere.

Accordingly, scale in DeFi is usually measured by total value locked (TVL) – the total value (usually expressed in terms of US dollars) of all the VAs locked in smart contracts at any given time. As of a recent date, almost $50 billion in VAs were locked in DeFi smart contracts.

DeFi platforms are generally promoted as being decentralised, although what is meant by this term in this context is open to debate. What can be said is that almost all DeFi products and services are automated, meaning that once a transaction is initiated by a user, smart contracts will carry out the transaction transparently and deterministically. Anyone with access to the internet can confirm the outcome of the transaction (although parties are identified only pseudonymously through the blockchain addresses used to execute the transaction).

Proponents of DeFi seek to create decentralised alternatives to nearly every traditional financial service, including lending, retail payments, deposit and savings accounts, swaps, options, and derivatives transactions, insurance, and asset trading, exchange, and management.

How does all this magic occur? DeFi is able to function without intermediaries because of a number of unique features. First, all DeFi transactions are either prefunded by the user or overcollateralised by the borrower. Second, due to the automation built into the various protocols, remedial actions (such as margin calls or default enforcement) can occur without the use of any time-consuming and costly legal process (and, of course, without regard to any traditional rights parties may otherwise have under any bankruptcy, reorganisation, or similar laws).

Third, many different digital assets have developed extremely high levels of liquidity (at least most of the time), meaning that pledged assets can be disposed of automatically and almost instantaneously without needing to relay on human intervention to find a buyer.

Most importantly, these platforms seek to distinguish between the smart contract code that is readily available to anyone interested to copy and, perhaps, improve upon and the individuals and legal entities they have formed to exploit and benefit from these various codebases. The former, it is argued, are the equivalent of public utilities while the latter are legitimate businesses that seek to benefit from these utilities in the same way that any other business may choose to do. Complicating matters, many DeFi platforms have issued digital assets (known as governance tokens) that allow the owner of the token to vote on certain governance matters and, potentially, receive a portion of the fees paid by users of the platform (generally, in the form of an in-kind distribution of portions of the digital assets borrowed or traded on the platform).

FATF's response

Things move very quickly in the world of blockchain. When the 2019 guidance was put in place, DeFi was bare a blip on the radar. Most VAs were transferred between

centralised digital asset exchanges or in privately negotiated transactions from one wallet to another (known as the OTC market). At that time, financial regulators around the world seemed content to focus on ensuring that these centralised entities implemented rigorous KYC/AML compliance programs and left it there.

However, things changed dramatically in the summer of 2020 (which came to be known as DeFi Summer). A confluence of factors led to an explosion in the use of these protocols and a virtuous cycle (which some might call a bubble) of demand for, and interest in, DeFi protocols. These factors included the successful deployment and maturing of a number of DeFi protocols, including Uniswap, Compound and Aave; the introduction of rewards in the form of governance tokens and other new VAs being distributed to those who made their existing VAs available for liquidity for trading by others (known as liquidity farming); increasing prices of "base assets" (bitcoin and ether) allowing more investors to feel bullish about experimenting with DeFi, and the Covid-19 pandemic causing more people to find themselves indoors with time on their hands. This activity fuelled across-the-broad asset price increases and in turn only created greater enthusiasm among users.

This rapid growth in VA activity through the use of DeFi protocols without a readily identifiable intermediary to be subject to AML/KYC compliance obligations may have caught FATF off guard. DeFi protocols generally operate in as frictionless a manner as possible and very few of these protocols are programmed to provide any sort of automated KYC/AML compliance checks. In fact, it is the opposite – most of these protocols allow users to interact with the protocols without any checks or identification whatsoever.

This raised a critical question for FATF: what would become of financial compliance if significant financial activity shifted to decentralised finance?

The draft guidance provides a simple answer: there is no such thing as "decentralised finance". Introducing FATF's revised position, the draft guidance states: "Where customers can access a financial service, it stands to reason that some party has provided that financial service, even if the act of providing it was temporary or shared among multiple parties." The draft guidance then expounds on this idea in greater detail:

> *The determination of whether a service provider meets the definition of a VASP should take into account the lifecycle of products and services. Launching a service that will provide VASP services, for instance, does not relieve a provider of VASP obligations, even if those functions will proceed automatically in the future, especially but not exclusively if the provider will continue to collect fees or realize profits, regardless of whether the profits are direct gains or indirect. The use of an automated process such as a smart contract to carry out VASP functions does not relieve the controlling party of responsibility for VASP obligations. For purposes of determining VASP status, launching a self-propelling infrastructure to offer VASP services is the same as offering them, and similarly commissioning others to build the elements of an infrastructure, is the same as building them.*

The FATF's position here amounts to a very dramatic shot across the bow to the DeFi community. If you are building the codebase for a DeFi protocol you intend to exploit or if you are otherwise directly or indirectly economically benefiting from that codebase, then, if the draft guidance is finalised in largely its current form and then adopted at the national level, you likely will be considered a VASP. Once you are considered a VASP, you would then be subject to the full range of compliance obligations that a centralised entity, be it a traditional financial institution such as a bank or broker-dealer, or a centralised digital asset exchange or custodian, would have.

This would mean that not only would an identifiable person or entity be required to conduct AML/KYC checks on the person that controls each blockchain address that interacts with the DeFi protocol, but also that sanctions checks – a notoriously tricky exercise that frequently produces false positives due to subtle differences in the spelling of individuals' names – would also need to be conducted.

A determination would need to be made for each transaction as to whether a suspicious transaction report (or the equivalent) would need to be created and submitted to the appropriate authority. A qualitative risk-based customer due diligence exercise would need to be conducted on the persons using the protocol and the protocol's VASP would need to consider whether they are dealing with other VASPs such that they have entered into the equivalent of a correspondent banking relationship with that VASP (and then conduct a risk-based diligence exercise on that other VASP).

The VASP for the DeFi protocol would also need to figure out how to implement the travel rule (a requirement designed for wire transfers between traditional financial institutions where information about the sender and recipient is tracked by the financial institutions processing the transfer and available to law enforcement and financial intelligence units, among others). In the United States, these new VASPs would likely need to obtain money transmission licenses in a large number of states.

Although some of these requirements could in theory – at least to some extent – be provided in an automated manner consistent with the draft guidance, there are (at least) three fundamental problems. First, large stores of personal data about the actual persons or businesses conducting the transactions will have to be stored somewhere, opening up the possibility of a cure worse than the disease – a major breach of these data stores, a particular risk if compliance is being implemented through the use of rapidly assembled automation platforms that haven't been robustly tested. Second, many of FATF's recommendations, being intended for centralised entities, have judgmental elements that are simply not

"DeFi platforms are generally promoted as being decentralised, although what is meant by this term in this context is open to debate"

possible to implement with automation. Hence, the apparent death knell for DeFi.

Finally, as the draft guidance is framed, there could easily be multiple non-affiliated persons or entities that would be considered a VASP with respect to any given DeFi protocol. The draft guidance gives no clue about how these multiple VASPs for the same protocol are meant to coordinate with each other.

Impact on traditional and decentralized finance

Prior to the release of the draft guidance, there was a reasonably clear correspondence between the responsibilities imposed on traditional financial institutions and those imposed on centralised businesses operating in the VA space. Although there are not insignificant costs involved in developing and maintaining a compliance programme consistent with the national implementations of FATF's recommendations, there is no practical reason why the FATF recommendations could not be adopted by VASPs that operate on a centralised basis. Likewise, as traditional financial institutions increase their engagement with VAs, it will be relatively straightforward for these entities to complement their existing compliance programs with additional elements designed specifically for their dealing in VAs.

The same is not true for the new class of inadvertent VASPs that would be created by implementation of the draft guidelines. These are individuals or businesses that helped to create DeFi protocols, who otherwise benefit economically, or who effectively control these protocols, often through the ownership of governance tokens. Whether an individual or a business, these persons very likely do not have either the economic wherewithal or the needed technical expertise to fulfil the obligations of VASP.

Moreover, there are many practical questions that immediately arise when attempting to apply compliance requirements on these otherwise unsuspecting persons. For example, as noted above, there could be more than one VASP for any given DeFi protocol (for example, any holder of governance tokens could be considered a VASP under the draft guidance). How would the requirements apply to these multiple entities? Might one or more of these inadvertent VASPs cease being a VASP with respect to the protocol at some point? Would selling your governance tokens mean that you were no longer a VASP? If you bought some or all of the tokens back, would you become a VASP again? If so, what does all this mean for recordkeeping and reporting by these inadvertent VASPs?

In addition, FATF's overall recommendations are clearly intended to apply to institutions that are able to employ a chief compliance officer, among many other things; how would a single individual comply? What penalties would apply to an individual for failing to comply? Finally, what about DeFi protocols that have already been created and are operational (but not otherwise in compliance and unlikely to change that status) – would these be grandfathered in some way or would there have to be a wave of look-back enforcement actions?

One might initially expect that the net result of the above situation (which might broadly be categorised under "it's a mess") would be to discourage the creation and maintenance of new DeFi protocols, full stop, and ensure that most if not all activity with VAs eventually takes place using centralized services. This would of course address the FATF's concerns about how to migrate their existing compliance framework originally designed for the fiat financial system into the world of VAs. This outcome would likely also suit traditional financial institutions, many of which initially steered wide of permissionless blockchain networks and the digital assets they host, and instead leaned into the much safer idea that the future of blockchain technology was in permissioned networks and distributed ledger technology (DLT). These institutions are now playing catch-up as they explore how to provide services involving a wide range of digital assets.

However, the DeFi genie may not head back into the traditional finance bottle quite so easily. The availability of interoperable, composable and transparently deterministic decentralised finance protocols has struck a major chord around the world. The interest in DeFi extends well past "crypto" aficionados. Traders, bankers, and investors from the world of traditional finance are daily discovering DeFi and abandoning traditional roles to help be a part of the DeFi revolution.

Institutional funding is streaming into the space, funding all manner of experimentation and research. Teams of only two or three skilled developers can create innovative and popular new protocols in a mere manner of months. Word of new protocols spreads virally among a devoted and well-informed community without the need for traditional marketing budgets.

Recognizing that DeFi is still in its infancy, participants readily acknowledge the risks involved but maintain that more centralised regulation is not the answer. Instead, proponents point to the remarkable level of transparency inherent in DeFi protocols as a major advantage over traditional financial services. Where regulators can watch the transactions occurring on DeFi protocols in real time as they occur, supervision of traditional finance is frequently a matter of "closing barn doors" – regulators generally only get data after the underlying transactions have occurred.

Moreover, one of most significant apparent drawbacks of DeFi – the fact that activity is extremely capital intensive due to the required overcollateralization of most activity (especially when compared with the equivalent activity in traditional finance) – has been addressed in a very DeFi way. Demand for credit in DeFi has led to the development of a vibrant on-chain lending market in which participants in DeFi transactions can borrow through other DeFi protocols. Hedging platforms and even protocols that resemble insurance are rapidly coming online.

"FATF's overall recommendations are clearly intended to apply to institutions that are able to employ a chief compliance officer"

The NFT wildcard

One almost completely unforeseen development over the last several months has been the exponential increase in the

awareness of, and interest in, non-fungible tokens (NFTs). Popularity has grown significantly among the general public – so much so that the widely distributed US television programme, Saturday Night Live, recently featured a skit on NFTs.

NFTs are unique blockchain-based digital assets that can reference artworks, video content (such as sports highlights), music files, magazine covers or virtually anything else. NFTs allow the owner to assert a special relationship with the underlying asset – much like having an autographed sports card. However, because NFTs are built using composable smart contract code, there is much more they can do, including changing the underlying asset referenced upon transfer or reacting to the geolocation associated with the wallet address in which the NFT is held. Although NFTs are not inherently part of the DeFi landscape, their compatibility with the many DeFi protocols already deployed and coming online means that they can be implemented in many ways. Recently, the latest version of the Uniswap digital asset exchange protocol (known as v3) implemented NFTs. Many other uses are anticipated over the coming months.

FATF nodded toward NFTs in the draft guidance, stating that:

> *Flexibility is particularly relevant in the context of VAs and VA activities, which involve a range of products and services in a rapidly-evolving space. Some items—or tokens—that on their face do not appear to constitute VAs may in fact be VAs that enable the transfer or exchange of value or facilitate [money laundering or terrorism finance]. Secondary markets also exist in both the securities and commodities sectors for "goods and services" that are fungible and transferable. For example, users can develop and purchase certain virtual items that act as a store of value and in fact accrue value or worth and that can be sold for value in the VA space.*

Although this observation is not surprising – traditional artworks have acted as a readily transferable store of value for many years and have likewise been used as part of the financing illicit activities for equally long, physical artworks must be handled by identifiable entities that may be subject to the FATF recommendations. NFTs are another matter altogether. They are highly liquid and can be easily transferred without intermediaries, demonstrating the challenges of attempting to import the traditional anti-money laundering framework into the realm of digital assets.

NFTs move fluidly among owners (or decentralised protocols), transferring value at one moment; looking like a simple collectible at another. Because of their programmability, NFTs can even shapeshift depending on the type of wallet in which they are stored. Imposing VASP status on anyone operating an NFT platform simply because virtually all NFTs have an inherent possibility of being used as a store of value may simply be a bridge too far for financial regulators in terms of achieving acceptance from the general public, yet failing to do so exposes an obvious exploitable loophole to consistent financial regulatory policy.

A way forward?

Many FATF observers believe that, regardless of the input received during the consultation period, the final version of the VASP Recommendations will likely closely resemble the draft guidance. That will leave it to national financial sector regulators to determine how best to implement FATF's recommendations in the context of their local regulatory frameworks. In the United States, that brings attention to the Treasury Department's Financial Crimes Enforcement Network (FinCEN). The robust dialogue between the major participants in the centralised digital asset space in the US (particularly digital asset exchanges) and FinCEN will be joined by all those interested in maintaining a viable DeFi ecosystem. It is harder to predict how these implementation discussions will play out.

That said, there is hope that many in the public sector will recognise the importance of allowing DeFi to grow and develop. Along with a potential for being used for illicit activities, it also has advantages from a regulatory perspective over the traditional financial system (which has suffered many black eyes over the past several years as a result of failing to prevent numerous significant cases of misuse in support of the financing of illicit activity).

At the same time, many DeFi proponents recognise that wholly unfettered DeFi protocols are invitations to abusive use by bad actors. The fact that little problematic activity in DeFi is known to have occurred at any significant scale so far may be attributed to the relative novelty of these protocols and the many practical risks still involved using them (criminals probably don't like losing money through poorly audited smart contract code, either). Now is the time to find appropriate compromises – before a major AML/CFT incident occurs.

One possibility is for FATF (or national regulators) to accept a more bifurcated approach to regulating the use of DeFi protocols. This could mean recognition that companies that develop, manage and benefit from centralised on-ramps (websites providing user-friendly interfaces for DeFi protocol software) will be treated as VASPs (or perhaps a slimmed down version of VASP) in order to facilitate the wider use of DeFi protocols, while still allowing crypto-native sophisticates who do not need a slick user interface experience to continue to access the command line smart contract code for DeFi protocols without engaging with intermediaries or otherwise being considered a VASP.

Critically, in this approach FATF would also recognise that simply owning governance tokens for a DeFi platform would not cause each holder to potentially be considered a VASP with respect to the platform, even if the governance token entitled the holder to a portion of the trading or other revenue or fees generated by the protocol. At the same time, DeFi protocol developers would be expected to implement the best available automated KYC software to limit the potential for misuse.

In addition, in this model, individuals and businesses that are acting on behalf of themselves on a proprietary basis (as opposed to investing third-party funds) would not be subject to a penalty if they accessed the underlying command line smart contract code for DeFi protocols, but anyone managing money or other value for others would be required to go through a VASP-operated on-ramp.

Like most compromises, such an outcome might not completely satisfy either financial regulators or die-hard DeFi enthusiasts, but it might just provide a possible alternative to the apparently untenable position currently found in the draft guidance.

Lewis Cohen
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On tour with investors – dos and don'ts for roadshows in Switzerland

The Swiss Financial Services Act introduced significant changes to the regulatory regime for financial service providers. **Benjamin Leisinger** and **David Borer** of **Homburger** analyse these changes and consider how best to prepare for a roadshow in Switzerland

Upon its entry into force on January 1 2020, the Swiss Financial Services Act (FinSA), first, significantly changed the regulatory regime applicable to financial service providers in Switzerland and, second, introduced a new and modern regime for the offering of financial instruments.

Financial services

Among other things, the FinSA introduced regulatory requirements for all persons and entities providing financial services (as such term is defined in the FinSA) on a commercial basis in Switzerland or for clients in Switzerland (financial service providers).

Financial service providers are now subject to the new conduct rules set out in the FinSA and need to take certain organisational measures set forth in the FinSA and those financial service providers that are not yet subject to a prudential supervision in Switzerland within the meaning of the Swiss Financial Market Supervision Act are required to have their client advisers registered in a newly established register for client advisers (*Beraterregister*).

Offering of financial instruments

Additionally, the FinSA introduced a new prospectus regime and introduced regulatory requirements applicable to advertisement for financial instruments.

Given that the rendering financial services and the offering of financial instruments are subject to regulatory requirements in Switzerland, the question whether roadshows qualify as financial services, an offer or an advertisement within the meaning of the FinSA – and what should be done to avoid this qualification – is of high practical importance for issuers, syndicate banks, distributors and brokers of financial instruments.

1 MINUTE READ

The Swiss Financial Services Act introduced new regulatory requirements for advertisements for financial instruments or services, for the provision of financial services, and for making an offer in Switzerland. Roadshows are events where all these regulations can become highly relevant – and before going on a roadshow the limits and consequences should be thoroughly analysed. This article may serve as a basis for 'dos and don'ts' and is also designed to help to identify potential red flags before going on a roadshow in Switzerland.

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Types of roadshows

The catchword 'roadshow' was the subject of many discussions and statements in the legislative process for the FinSA.

A roadshow is an event where issuers, syndicate banks, distributors or brokers meet with existing of potential future investors or their financial intermediaries. However, when talking about roadshows and the regulatory requirements applicable to them (if any), it is important to distinguish the different types of roadshows as they could raise quite different regulatory issues under Swiss law.

Generally, a basic distinction is made between 'non-deal roadshows' and 'deal roadshows', although the lines may get blurred in practice.

Non-deal roadshows

Non-deal roadshows are events where the management of a company introduces itself, explains the business model, financial results, recent developments or other relevant aspects of the company – or simply takes the opportunity to meet existing shareholders or other investors and to check-in with them and their expectations or views. As such, non-deal roadshows are unrelated to specific transactions.

Deal roadshows

Deal roadshows on the other hand are meetings that are meant to promote the interest of investors with respect to an upcoming offer of shares, bonds or other financial instruments. As such, deal roadshows typically are ultimately aimed at the purchase or sale of a particular financial instrument.

Within the notion of deal roadshows it is typically further distinguished between roadshows that are held at an early stage of a transaction and roadshows that are held at a later stage, i.e. when the transaction is already more advanced.

If done at an early stage of a possible transaction, a roadshow serves the purpose of merely 'testing the water' or 'pre-sounding' with investors whether they would be interested at all in a specific financial instrument from the relevant issuer.

This is done mainly when an issuer plans to publicly issue a certain instrument the first time or when it is an instrument with innovative features. At this point in time, no particular financial instrument exist and it is not even clear whether it will ever be issued. However, deal roadshows are also often done in parallel to a specific offering of financial instruments.

The main purpose of such roadshows is to present the offered instruments and to answer specific questions from professional investors or banks in relation to the specific features. At this point in time, the transaction is already at a rather advanced stage and it is already clear that a financial instrument will be issued and what the specifics of such instrument will be.

Relevant concepts of the FinSA potentially applicable to roadshows

There are three legal concepts under the FinSA that are potentially relevant in the context of a roadshow:

- Advertisement pursuant to Article 68 of the FinSA;
- The provision of a financial service pursuant to Article 3(c) of the FinSA; and
- Making an offer pursuant to Article 3(g) of the FinSA.

It is important to note that these are three individual concepts that have different regulatory requirements and that may – or may not – be triggered simultaneously in the context of a roadshow.

Advertisement

Under the FinSA, the advertisement of financial instruments in the sense of Article 3(a) of the FinSA (or for financial services pursuant to Article 3(c) of the FinSA) is regulated.

The concept of advertisement under the FinSA is a rather broad and, pursuant to its definition in Article 95(1) of Financial Services Ordinance (FinSO), covers any communication that is aimed at investors and serves to draw attention to specific financial services or financial instruments.

Advertisement for financial services must be labelled as such (Article 8(6) of the FinSA). This duty does not apply to advertisement for financial instruments, but advertisement for financial instruments

must still be clearly identified or identifiable as such (Article 68(1) of the FinSA).

In addition, any advertisement for financial instruments needs to include a reference to the prospectus or the key information document relating to the respective financial instrument (to the extent available) and where such documents can be obtained (Article 68(2) of the FinSA).

Furthermore, advertising and other information on financial instruments intended for investors must correspond to (i.e. not contradict) the details given in the prospectus and the key information document.

In order to avoid that a non-deal roadshow qualifies as advertisement under the FinSA, information about financial instruments – such as a company's shares – should ideally be avoided.

If the roadshow materials do include certain information financial instruments – such as information about shares and their latest price on the relevant exchange, or outstanding bonds in the general slides about the company – a disclaimer should be added to the effect that this qualifies as advertisement.

Given the rather broad definition of advertisement in the FinSO, deal roadshows will in most cases constitute an advertisement for a financial instrument. Therefore, as a general rule, and to ensure compliance with the requirement that advertisement for financial instruments must be identifiable as such, a disclaimer should be added whenever existing or specific potential financial instruments are mentioned.

When the deal roadshow is done after the 'testing' or 'pre-sounding' phase, it should also be stated clearly that the roadshow documents do not qualify as a prospectus or a key information document in the sense of the FinSA – this is mainly to avoid a potential prospectus liability for such documents.

In case the transaction is already more advanced and a prospectus or a key information document already exists, the roadshow documents must:

- State where these offering documents can be obtained; and
- The information presented during the roadshow must not contradict the information in these offering documents.

Financial service

When compared to advertisement, the concept of financial services is relatively narrow. It only covers a list of specific services with respect to financial instruments that are provided to clients (Article 3(c) no. 1-5 of the FinSA).

The FinSA does not contain a definition of 'clients'. However, the legislative materials highlight that the FinSA means, and is designed to protect, 'end customers'". Out of said enumerative list, three activities are of specific importance in the context of roadshows:

- Acquisition or disposal of financial instruments;
- Receipt and transmission of orders in relation to financial instruments; and
- Provision of investment advice.

In connection with the 'acquisition and disposal of financial services', the ordinance quite vaguely states that it covers "any activity addressed directly at certain clients that is specifically aimed at the acquisition or disposal of a financial instrument" (Article 3(2) of the FinSO).

Notwithstanding this broad definition, it is very important to highlight that the implementing ordinance, FinSO, clearly – and unambiguously – excludes the placement of financial instruments as well as the associated services from the definition of a 'financial service' under the FinSA (Article 3(3)(c) of the FinSO).

In other words, IPO or bond roadshows and similar events for the mere placement of financial instruments as such do not qualify as a financial service. The broad definition in Article 3(2) of the FinSO was mainly introduced to cover, and regulate, certain roadshows for foreign funds in Switzerland where not only the funds and their features are explained, but entire investment strategies are frequently discussed with potential investors.

In light of the abolishment of the license for fund distributors in Switzerland, the legislator obviously wanted to ensure that investor's interests are still protected at such events.

> ***"It is key to avoid that the roadshow qualifies as 'investment advice' or the 'acquisition or disposal of financial instruments'"***

If the activities at a roadshow were to qualify as a financial service, issuers or investment banks would be subject to certain conduct rules, client segmentation requirements and even the duty to register client advisers in a register.

In order to avoid that a deal roadshow is qualified as a financial service, it is key to avoid that the roadshow qualifies as 'investment advice' or the 'acquisition or disposal of financial instruments'.

To ensure this, first, any statements that could be investment advice, such as suggesting that a financial instrument would be a good investment for the attending persons or that a financial instrument would be a good addition to an investor's portfolio, should be avoided.

Further, during deal roadshows any statements should be limited to describing the instrument and its features but not discuss any needs or opportunities for the investors. Moreover, when running a deal roadshow, no orders should be accepted and forwarded with respect to financial instruments on the investors' behalf (note that solely acting on behalf of an issuer would still be exempted from the notion of the provision of a financial service).

To mitigate the risk of providing a financial service even further, the attendees could also be limited to such that do not – or not typically – qualify as 'end customers'. In other words, inviting private banks and asset managers or investment advisers is safer than inviting investors directly.

Slides for roadshows often include disclaimers explicitly stating that no investment advice is given, and it is advisable to do so. However, merely adding disclaimers does not help if the actual behaviour does not follow.

Offer

An offer within the meaning of the FinSA exists if a communication of any kind (oral or in text form) is made which:

"This article hopefully serves as a basis for doing this in advance of a roadshow in Switzerland"

- Contains sufficient information on the terms of the offer and the financial instrument; and
- Is customarily intended to draw attention to a certain financial instrument and to sell it.

Accordingly, each offer has an objective component (sufficient information) and a subjective component (the intention by the offeror to sell a specific financial instrument).

An offer under the FinSA can trigger a prospectus requirement – when considered to be public (Article 35 of the FinSA) – or the duty to prepare a key information document – when addressed to retail investors ('private clients' in the FinSA) and concerning certain financial instruments with a derivative component (Article 58(1) of the FinSA).

To avoid that a roadshow presentation triggering a prospectus requirement or requirement to have a key information document, references to financial instruments should be avoided.

In the case of a deal roadshow when it is all about specific information on a financial instrument, the selection of attendees is important: the requirement to have a prospectus or a key information document can be avoided by exclusively inviting 'professional clients' within the meaning of the FinSA.

Under the FinSA, the definition of 'professional clients' is relatively broad and includes Swiss or foreign financial intermediaries (banks, securities houses, portfolio managers, trustees, managers of collective assets, fund management companies, collective investment schemes and persons who are responsible for the safekeeping of assets held in them, persons who represent foreign collective investment schemes in Switzerland), insurance companies, central banks, public entities with professional treasury operations, occupational pension schemes with professional treasury operations and other occupational pension institutions providing professional treasury operations, companies with professional treasury operations, large companies, and private investment structures with professional treasury operations created for high-net-worth retail clients.

In the absence of indications to the contrary, the offeror may, for the purposes of relying on the exemption from the prospectus obligation, assume that professional clients have not declared that they wish to be treated as retail clients.

The devil is in the detail – so be prepared

It comes as no surprise that it is not black and white when analysing whether a certain roadshow qualifies as advertisement, a financial service or an offer.

What can be done, however, is to take precautions by way of disclaimers, selection of invitees and the preparation (and training) of dos and don'ts in advance of such events. This article hopefully serves as a basis for doing this in advance of a roadshow in Switzerland.

Looking at the upside: how SPACs can win

Derek Elmer and James Tunkey of I-OnAsia explain how professionals working on SPACs can set their strategies accordingly to succeed and bring a competitive advantage to their deals

www.ionasia.com.hk

In business, there are few things that bring greater joy to an executive than being wildly successful. However, sometimes it does feel better when there is success despite loud opposition from critics in the market and you best your competition in the process.

It is a fair prediction that SPACs are always going to attract the haters and the posers, and that there will always be obstacles to overcome.

Trouble makes for good headlines. If the story bleeds, it leads. The financial press and social media platforms will always get their clicks from negative headlines, whether they are about SPAC failures, share price drops, or new US SEC rules and enforcement actions. Indeed, the clickbait trifecta was seen earlier this year with announcements of SEC investigations into failed SPACs that had been promoted by celebrities who thought being a 'CEO' on TikTok meant the same as it does in the business world.

As this article is being written, the weighted performance of a basket of US SPACs is down over 20% from a 2021 peak (see chart on following page).

At similar points in any cycle of growth, one can often tend to see gloomy feedback loops emerging, with professional advisors issuing warnings of impending doom if something is not done to fix a perceived compliance problem.

Right on cue, as this note goes to press in the early summer of 2021, email inboxes are being flooded with alerts from white collar teams highlighting the potential for regulator penalties on SPACs and the threat of shareholder lawsuits. Even so, perhaps it would be good to take a step back from these 'all stick and no carrot' messages and ask, "What about the upside?" Surely there are benefits for SPACs to embrace better legal, risk, and compliance that go beyond avoiding fines and regulatory sanctions. What are they?

This article attempts to briefly articulate a more constructive orientation for legal, regulatory, and compliance

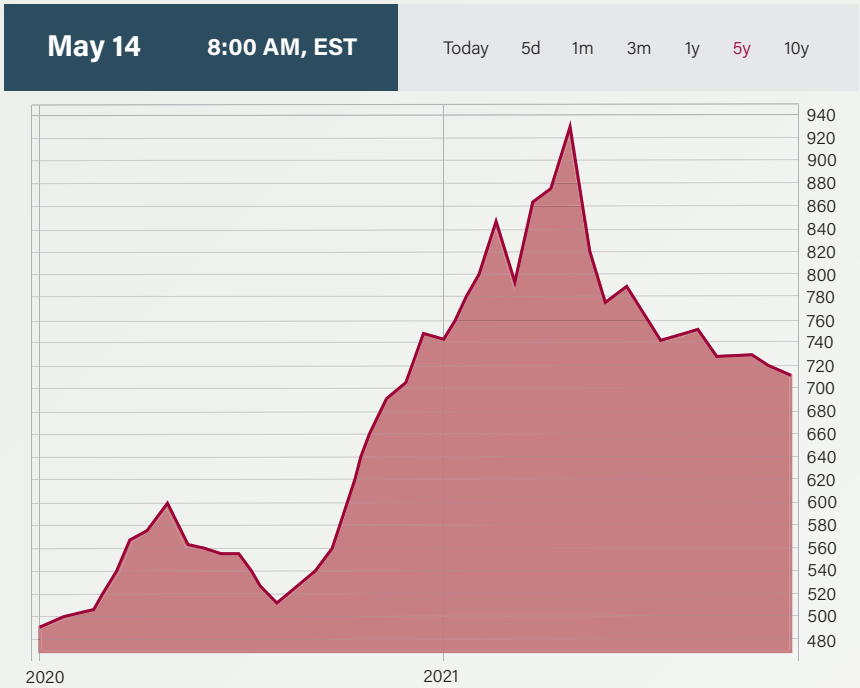

Chart: IPOX SPAC Index May 14 2021

(LRC) professionals and other readers of the IFLR, including in-house counsel, senior partners at large law firms, SPAC CEOs and boards and their advisors.

Orient towards the four 'T's to success

Poll any group of successful long-term investors to identify the secrets to success, and you are likely to hear a version of the mantra: "Team. Timing. Technology." The most seasoned venture capital and private equity investors and heads of family offices know, however, that there is a fourth key to future success: Testing.

The first three 'T's make perfect sense. A great team can find a way to thrive, even when the going is rough. Get the moment right, and the returns can be phenomenal. Brilliant tech reaches more customers more efficiently, leading to higher valuations. Yet, the fourth 'T' is also essential. Business leaders must test their assumptions to avoid falling victim to their own bias, conserve precious cash, and make great investments.

Testing is core to what LRC professionals do all day long. SPACs should avoid taking an 'eat your peas' approach that puts testing in opposition to the rest of the business. LRC talent should not just test. They should make an expanded and more constructive contribution, particularly given their importance in the idea economy.

SPAC leaders should remember, for example, that great legal work was essential to the creation of iTunes and the App Store. Sure, Steve Jobs did a fine job – but the lawyers who wrote the strategic agreements with music industry partners, and who penned the end-user subscription contracts, were also critical innovators who contributed to the growth of the world's first trillion dollar business.

So far, this more constructive orientation does not appear to have been adopted.

When the rosters of SPAC teams are examined, one can see that SPACs have attracted hundreds of prominent and experienced founders, CEOs and CFOs. However, only a few SPACs spotlight stars are from the LRC community, based on data maintained on the popular platform SPAC Track. Of the 849 SPACs listed by SPAC Track in mid-May 2021, only four (less than half of 1%) were identified as having a prominent general counsel, chief risk officer, or compliance officer among their lists of SPAC leaders, directors and advisors.

This data aligns with anecdotal experiences at I-OnAsia, where the core business includes performing due diligence background checks on management teams on behalf of underwriters. Very few of the subjects of inquiries into SPAC management teams have included professionals with a background in legal, risk, or compliance.

These facts and observations hint at lost upside.

> *"Of the 849 SPACs listed by SPAC Track in mid-May 2021, only four (less than half of 1%) were identified as having a prominent general counsel, chief risk officer, or compliance officer among their lists of SPAC leaders, directors and advisors"*

Preservation instincts

To win, a SPAC must hire great LRC talent, include them among the core C-suite team, and focus them on business growth.

Fintech SPACs seem to be a particularly rich area for LRC professionals to put their natural instincts for preservation to good use. When fintech SPACs focus on market segments that involve high risk products or counterparties (or both), the best LRC talent can help identify safe paths upon which the business

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I-OnAsia is a market leader in pre-IPO and M&A due diligence. I-OnAsia regularly performs background screenings around SPAC listings and de-SPAC transactions in Asia, the Americas, and Europe. I-OnAsia's risk advisory consultancy helps companies address the challenges of international trade, including performing Foreign Corrupt Practices Act (FCPA) checks and customer due diligence as well as CFIUS reviews, not just in Asia.

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may take a step forward, but where others may get tripped up. The field seems wide open. As of mid-May 2021, there are only two fintech SPACs with LRC superstars spotlighted by SPAC Track.

After the colossal $20 billion blow-up of Archegos Capital in 2021, financial firms with reportedly strong risk management approaches were in a stunningly advantageous position in comparison to their lesser competitors. Archegos was a privately run hedge fund, also known as a family office, run by Bill Hwang. Hwang was a customer of many major banks, but he was over-leveraged and had become a bad bet in the run-up to his collapse. Of the financial firms serving Archegos, those with reportedly less robust risk and compliance approaches got hung up, suffered severe losses and stark share price drops. The Archegos debacle clearly showed that successful LRC teams can preserve capital as a means of creating advantage and generating new avenues for growth.

It is much easier to compete when your peer has suffered a stunning wipe-out of years' of its profits and has embattled leadership.

There is a wider lesson here for SPACs.

Mature companies have c-suites stuffed with all manner of LRC professionals who help achieve revenue and profit predictability. Unfortunately, there are many reasons why a mature operating company that has generated strong revenues for years and is on a growth path to tremendous profitability will not choose to access the public markets through a SPAC or de-SPAC transaction.

This limits the universe of the types of companies attracted to SPACs: ones with less revenue and profit predictability. Investors will demand a higher risk premium for such businesses, increasing their cost of capital. To the extent, therefore, that LRC professionals can help a SPAC avoid such wild twists of fate and generate more reliable growth, they will be adding shareholder value by lowering the venture's borrowing costs.

Fraud prevention

One critical challenge SPACs should be positioning themselves to address is operational risk (OpRisk); regardless of whether the SPAC's orientation is financial services, space, or China.

OpRisk losses tend to be larger after boom cycles and periods of easy money, mostly due to increased levels of internal fraud and improper business practices, according to a recent working paper published by the Bank for International Settlements (BIS), a multilateral. Actually, historic data collected by the BIS identifies fraud as a significant OpRisk at any time. So, it would not hurt for SPACs to seek assistance from fraud specialists.

The constructive purpose for their inclusion is to beat the competition and prove the SPAC critics wrong. This will require an open and multi-dimensional mindset by SPAC executive leaders. However, this has really been a best practice for decades, at least since a panel of experts on financial reporting quality known as the Treadway Commission issued a study on the topic.

As SPACs and de-SPAC transactions often involve a universe of companies with

less of a track record for generating profits (or even revenue), a specific focus for legal, risk and compliance should include lending a hand to test the quality of financial statements.

Simple due diligence on all audits would be a good start, checking for errors and overstatements on balance sheets and income statements. Financial fudging can spring from unseen biases of business leaders seeking to satisfy the animal spirits of the market. Joseph Wells, the founder of the Association of Certified Fraud Examiners (ACFE), has written that the "most common reasons why senior management will overstate business performance" are to "meet or exceed the earnings or revenue growth expectations of stock market analysts".

LRC professionals should also be invited to prevent bad decisions stemming from conflicts of interest, which can result in a loss of investor capital or leaders' reputations. "The inadequate disclosure of conflicts of interest is among the most serious of frauds", writes Wells. LRC teams play a critical role in testing the integrity of any de-SPAC transactions to ensure they are negotiated in good faith.

Enhanced due diligence can play a key role in looking for red flags. Before the screening process, the LRC team can consider what are the best risk indicators specific to the transaction. These may be nuanced, and involve tests of character, performance, and track record. The goal is an independent and unbiased product that addresses governance, performance, and leadership aspects. Enhanced due diligence teams can even examine supply chain vulnerabilities, test the robustness of products in the pipeline, and consider other issues. For example, LRC teams and specialist risk management vendors can be ethically track peers and keep a finger on the pulse of the market to ensure a solid feel for market timing.

Lean mean pro-business machines

For over 20 years, the team at I-OnAsia has supported in-house counsel, board risk committees, and corporate compliance teams with due diligence and other risk management services on both sides of the Pacific, as well as in Europe. Along the way, it has seen many savvy LRC customers find a way to do their jobs without running bloated departments. SPAC LRC teams must find ways to stay lean and avoid becoming a drag on the business.

Unfortunately, a majority of banks spend significant sums on these functions. For example, according to a 2018 Risk Management Association study, 50% of institutions surveyed spent between 6% and 10% of their annual revenue on compliance costs, which is a lot. Sometimes these large costs are a necessary function of an entity's importance to the global economy, but still create a competitive disadvantage.

One way to avoid becoming too costly is to include LRC teams in technology strategy setting; internalising LRC needs into the firm-wide digital strategy and embracing new tools that can help the business scale to address the risks of the future most competitively. Another very successful approach has been to actually populate the c-suite with more than one senior risk management professional. Executive committees with multiple members who understand risk are in a better position to address tomorrow's challenges most cost-effectively.

Balancing act

Getting all of this right is a balancing act.

As their nickname 'blank check company' implies, SPACs have firm-specific mandates to take investor capital and spend it wisely. So, the stakes are raised for SPAC leaders. If they want to enjoy success, they will have to get all four 'T's very, very right, because they may only have one shot.

Most SPAC executives are already well-aware of the challenges. They have heard the critics and have listened to warnings from the regulators. LRC professional officers can offer business leaders so much more than warnings. Their instincts, skills, and experiences can bring competitive advantage.

Awaiting the arrival of SPACs in Japan

Katsumasa Suzuki, Masakazu Kumagai and Yu Nimura of Mori Hamada & Matsumoto explore the challenges and solutions that the introduction of SPACs in Japan will create for the country's capital market

Mori Hamada & Matsumoto

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Attention to SPACs is increasing in Japan. Well-known Japanese investment companies have listed SPACs in the US, and some of the US-listed SPACs are targeting Japanese companies.

The Japanese government has begun to discuss the introduction of a Japanese version of SPACs (J-SPACs) in Japan. On June 2 2021, the Growth Strategy Conference, an advisory board to the Japanese government, published a draft of the growth strategy implementation plan, which indicates that in light of the experiences of the US and other foreign regulators, general trends of the SPAC market and the perspective of enhancing Japan's international competitiveness, the Japanese government will consider introducing J-SPACs while taking adequate measures required from an investor protection perspective. While the US SEC is strengthening its monitoring as the SPAC boom heats up in the US, Japan is still on the other end of the spectrum. It would be worthwhile for Japan to consider the pros and cons of introducing J-SPACs by looking at experiences in the US market.

In addition, as a more impending issue, Japan would see situations where Japanese companies will consider listing in the US market through business combinations with US SPACs.

Lawyers, investment banks, venture capitalists and private equity (PE) funds, as well as the relevant Japanese regulators, have led the discussion relating to SPAC by publishing thought leadership articles. In this article, major legal issues are summarised on (i) the business combination of Japanese companies with US SPACs; and (ii) the introduction of J-SPACs.

"If any of the SPAC managers intend to join in the management of the target company, the SPAC would not qualify for the exemptions"

The business combination of Japanese companies with US SPACs

Transaction structure

In the US, de-SPACs are typically carried out by way of a reverse triangular merger using SPAC shares as merger consideration. Although a reverse triangular merger is not available under Japanese corporate law, it would be possible, purely from a Japanese corporate law perspective, to create substantially the same capital relationship by way of:

- A 'triangular share exchange' followed by the merger of the merger subsidiary into the target company (with the target company being the surviving company); or
- A 'forward triangular merger' (with the target company being the dissolving company).

While the 'forward triangular merger' structure under Japanese corporate law is similar to that used in the US, the 'triangular share exchange' structure is illustrated in the chart on the following page.

However, the feasibility of these transaction structures should also take into account the specific facts and circumstances of the entities involved, particularly from the taxation and regulatory perspective.

Set out below is a summary of applicable tax treatment to the target and its shareholders in each scenario.

Restrictions under foreign investment control regulations

Under the Foreign Exchange and Foreign Trade Act of Japan, generally, a foreign investor intending to acquire shares of an unlisted Japanese company engaging in certain designated businesses must file a prior notification with the Minister of Finance and other competent ministers, including the Minister of Economy, Trade and Industry, irrespective of the number of shares to be acquired.

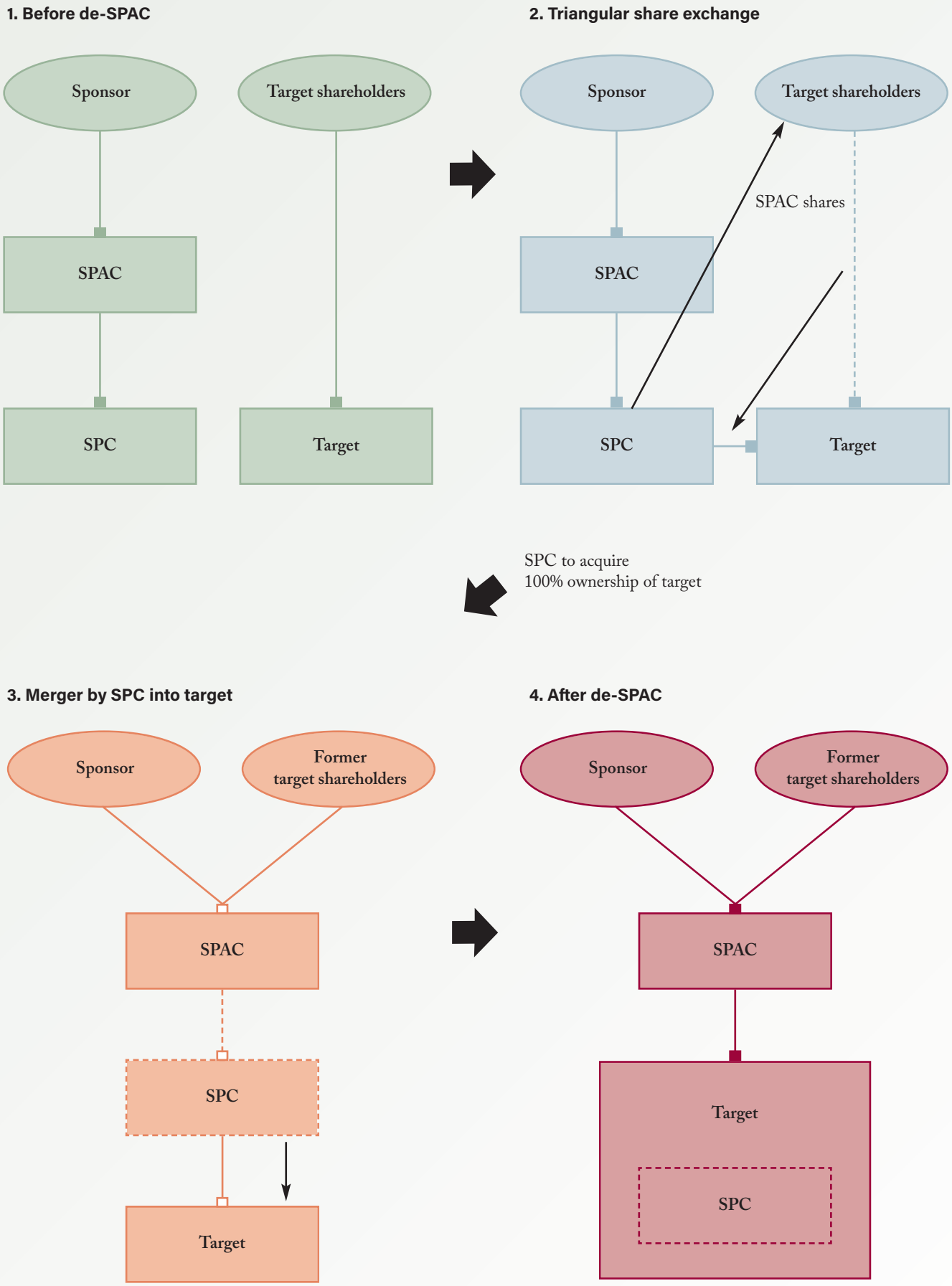
While there are certain exemptions, if any of the SPAC managers intend to join in the management of the target company, the SPAC would not qualify for the exemptions and therefore, a prior notification must be filed. In addition, no exemption is available if the target company engages in certain highly-sensitive businesses, in the so-called 'core' business sectors, including the manufacture of semi-conductors and software.

If a prior notification is filed, the proposed acquisition cannot be consummated until a 30-day waiting period has lapsed from the date of filing (although this period may be shortened or extended up to five months). The ministers may ultimately order the acquisition to be modified or stopped after considering various factors, including the management and investment policy of the foreign purchaser and the relationship of Japan with the government of the place of organisation of the foreign purchaser as well as any person effectively managing it.

Disclosure

In the proxy statement to be issued in connection with a de-SPAC, the US SEC rules require the SPAC to include two to three years of audited financial statements of the target, which must comply with US generally accepted accounting principles

	Triangular share exchange		Forward triangular merger	
	Tax-qualified share exchange	Non-tax qualified share exchange	Tax qualified merger	Non-tax qualified merger
Target	Non-taxable	Mark-to-market tax, while the scope of the	Non-taxable	Capital gains tax
Target shareholders	▪ If cash consideration is included, capital gains tax ▪ If the consideration consists only of SPAC shares, no capital gains tax		Non-taxable	▪ If cash consideration is included, capital gains tax ▪ If the consideration consists only of SPAC shares, no capital gains tax ▪ Deemed-dividend tax in addition to capital gains tax


1. Before de-SPAC
Sponsor
Target shareholders
SPAC
SPC
Target
2. Triangular share exchange
Sponsor
Target shareholders
SPAC shares
SPAC
SPC
Target
SPC to acquire
100% ownership of target
3. Merger by SPC into target
Sponsor
Former
target shareholders
SPAC
SPC
Target
4. After de-SPAC
Sponsor
Former
target shareholders
SPAC
Target
SPC

(GAAP) or the International Financial Reporting Standards (IFRS) in certain cases, as well as the *pro forma* financial statements of the combined company. For targets that have not had a public company audit, the preparation of financial statements could impose a significant burden and delay the timing of the completion of the de-SPAC.

The target business disclosure in the proxy statement is similar to what would be required in a Form S-1 IPO prospectus of the target's business, including a detailed description of the business, management discussion and analysis (MD&A) and background of the de-SPAC and projections of the target company. Furthermore, after the de-SPAC, the combined company will need to comply with the continuous disclosure obligations and the internal control requirements under the US Sarbanes-Oxley Act of 2002 (SOX Act).

In reality, generally, Japanese private companies do not prepare IFRS-compliant financial statements or disclosure documents in English nor do they establish effective internal controls compliant with the US SOX Act. Therefore, it is important for the SPAC to analyse the target's capabilities relating to disclosure and internal control during the due diligence process, and to procure the management's commitment regarding these matters in the de-SPAC definitive agreement.

Legal issues in introducing J-SPACs

Listing criteria and requirements

As the current listing criteria of Japanese stock exchanges does not jibe with the nature of SPACs, it would be necessary for the stock exchanges to design listing criteria and requirements that are applicable to SPACs.

In addition, Japanese stock exchanges need to modify their listing examination practices for SPACs. Unlike the US, where issuers and underwriters retain their respective lawyers to conduct due diligence and prepare disclosure documents, and the stock exchanges and SEC do not conduct substantive examination, a Japanese stock exchange traditionally undertakes a comprehensive and substantive examination of the listing applicant for over a year or more, partly because issuers and underwriters generally do not retain lawyers in Japanese domestic IPO deals due to the low litigation risk. In other words, in the US, investor protection focuses on fair disclosure supported by a severe litigation risk, while in Japan, the stock exchange is expected to conduct, and has in fact conducted, 'paternalistic' investigations on behalf of investors.

> *"The introduction of J-SPACs would be an important challenge for the Japanese capital markets"*

Substantive investigations by stock exchanges in Japan are not practicable during the life span of the IPOs of SPACs and de-SPACs considering that these processes may be completed within a short period.

A theoretically possible approach under the existing listing rules would be to apply the rules relating to 'back-door listing' to the SPACs. Under these rules, if it is discovered that a listed company is not a substantive surviving company after a merger or otherwise with an unlisted company, the listed shares will be designated as securities under supervision, and the listed company will go through an examination that is equivalent to a listing examination. The listed company will be delisted if it is found that it does not meet the listing criteria within a certain period of time.

If J-SPACs are to be introduced in the future, it would be necessary for the Japanese stock exchanges to revisit the manner of investor protection that should be pursued for SPAC investors. This includes whether and how much the stock exchanges will rely on the substantive examination, and to design – if necessary – the workflow of the substantive examination, so as to be practically consistent with the timeline of SPACs and de-SPACs.

SPAC schemes

Units

At the time of the IPOs of US SPACs, units are typically issued to investors, each of which consists of a share of SPAC common stock and fraction of a warrant exercisable for SPAC shares, which will be separated after a certain period of time. Apparently, this 'unit' structure is adopted for ease of market stabilisation. If a similar unit structure is necessary for the IPOs of J-SPACs, it should be noted that there is currently no settlement system or mechanism on which shares and stock acquisition rights can be traded as one unit.

However, a similar effect may be achieved under the current Japanese corporate law and settlement system. Assume that at the time of the IPO, only shares will be issued, but the board of directors of the J-SPAC will approve a resolution on a gratuitous allotment of stock acquisition rights (i.e. *pro rata* allotment to SPAC shareholders of stock acquisition rights without contribution immediately upon the IPO) which will take effect on a specific date after a certain period of time. Through this mechanism, the SPAC shares will be tradable with a right to receive a *pro rata* allotment of the warrants until the ex-rights date.

Redemption

For US SPACs, general SPAC shareholders have the right to have their SPAC shares redeemed upon their request at the time of the de-SPAC or if the de-SPAC transaction is not completed within the prescribed timeframe.

Under Japanese law, there are no material issues if such a redemption feature is included in the terms and conditions of the class of SPAC shares held by such shareholders. The class of shares issued to general SPAC shareholders would be different from those issued to SPAC sponsors, as the sponsors are not given the right to have their SPAC shares redeemed.

Disclosure for SPAC IPO and de-SPAC

It would be necessary for the regulator to consider designing a new SPAC-compliant disclosure regime. More specifically, under Japanese securities regulations, IPO disclosures would be made by the SPAC by filing a securities registration statement, just like a traditional IPO. However, as the SPAC will not be conducting any business at the

time of the IPO, its disclosures would be significantly different from ordinary companies, and the existing disclosure form would not be appropriate in that it includes many items that are not relevant for SPACs.

In addition, under the existing Japanese securities regulation framework, even if the consideration for the de-SPAC includes SPAC shares, material information on the target company (such as the nature of its business and risk factors) would not be required to be disclosed at the time of the de-SPAC. This is because the registration requirement is not applicable to a reorganisation that involves the distribution of shares as consideration if the shares to be distributed are already listed.

It is true that a convocation notice including agenda items relating to the proposed de-SPAC will be circulated by the SPAC for the shareholders meeting, but under the Japanese regulatory regime, such convocation notice is governed by corporate law and not by securities regulations.

Conclusion

As investors flock to SPACs in the US, the world's largest capital market, the impact on the Japanese capital market and M&A market would be inevitable. SPAC schemes have some issues that may not be easy to harmonise with traditional IPO practices in Japan. However, the US SPAC boom seems to imply that traditional IPOs alone cannot meet the evolving needs of the capital markets, and the same can be said for Japan, when strong demand for J-SPACs from unicorns, venture capitalists, PE funds and investors are seen.

The introduction of J-SPACs would be an important challenge for the Japanese capital market to fulfil its function to properly supply risk money. As said, lawyers have led the discussion among market participants, including the regulators, on concepts relating to SPACs in Japan, and will continue to contribute for the development of capital markets in Japan by introducing SPACs to Japan, with cooperation with players outside Japan as well.

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Katsumasa has advised in many sophisticated deals in Japan, such as on the global IPOs of the Japan Post group companies, Recruit and Mercari. He has chaired the M&A sub-committee (2018-2020) and the public company practice and regulation subcommittee (2020-present) in the security law committee of the International Bar Association.

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CAPITAL MARKETS
ESG

Data centre securitisation in Europe

Simon Porter, Jeremy Levy, Sarah Porter and Joana Fragata of Baker McKenzie look at how trade receivables financing could be a valuable weapon in a data centre's financial armoury

The pace of digital transformation has been accelerating worldwide. As part of this continued growth trajectory, the use by corporates of data centres has become essential. The Covid-19 pandemic has given an additional boost to the expansion of the digital economy, as businesses adapt to home-working and additional data needs. Planning for an increasingly digital and innovative future will rely not only on the existence of appropriate infrastructure but also on the ability of market participants to access it.

In addition, the European Green Deal and the European Digital Strategy – an ambitious green and digital revolution led by the European Commission which impacts a number of different sectors of the economy – includes a target to decarbonise data centres by 2030. This will require substantial investment from European data centre providers and will undoubtedly prompt them to consider carefully the funding options available to drive this growth.

While traditionally data centres have been viewed as infrastructure assets, attracting infrastructure-specific financing solutions, they are rapidly becoming much more than that. The trend towards the provision of data centre services – through cloud-based solutions designed to serve end customers – is likely to require a reassessment of the existing approaches to their financing. This article considers how trade receivables financing could become a valuable financing tool for data centre providers in Europe.

The use of asset-backed financing in relation to data centres is a relatively recent phenomenon in the US – the first rated data centre securitisation closed in 2018. To date, these data centre securitisation transactions have typically involved securitisation of loans backed by data centre infrastructure through the issuance of commercial mortgage-backed securities (CMBS), whereby the rents paid by data centre tenants generate the required cash-flows to service

"While traditionally data centres have been viewed as infrastructure assets, attracting infrastructure-specific financing solutions, they are rapidly becoming much more than that"

the asset-backed securities. More recently, there has been a move to master trust platforms to securitise operational revenue.

In Europe, as at the date of this article, there have been no public data centre asset-backed financing transactions. This might be explained by the prevalence of loan and corporate bond financing in this sector and the reluctance of market participants to engage in novel transactions, where the lack of comparable experience may pose challenges to their pricing, structuring, rating and marketing to investors. Additionally, while CMBS has recently made a comeback in Europe, it has continued to focus on the traditional sectors (retail, logistics and hospitality), while infrastructure and whole business securitisation have not become widespread funding tools.

As the data centre sector evolves, alternative structures – other than the infrastructure or operational-based financing structures tried and tested in the US – may start to emerge as credible alternatives for financing of data centres, in particular as the sector evolves and the demands on data centre entities to expand and modernise their business intensify.

Colocation data centres have recently emerged as a flexible alternative for companies seeking to access data centre infrastructure without the associated heft and cost. The emergence of Data Centre as a Service (DCaaS) business models could have a profound impact on data centre financing, as the supply of DCaaS services will generate a stream of cash-flows arising from trade relationships which can be monetised using trade receivables financing, in particular asset-backed commercial paper (ABCP).

Compared to CMBS and whole business or infrastructure financing, trade receivables financing offers increased flexibility, allowing market participants to structure their own transactions or to tap into existing ABCP financing platforms, often at a pan-European level. ABCP is therefore a particularly effective financing tool for data centre entities operating across borders.

Trade receivables as an asset class

Moreover, trade receivables is an asset class with an established market in Europe. Over the past couple of decades it has endured testing market and economic conditions and proved its resilience. It is also seen by key stakeholders, such as governments, supranational entities and regulators, as one of the key tools to kick-start the post-pandemic recovery. The trade receivables market is particularly well suited to bespoke transactions and could complement other more traditional forms of data centre financing. Moreover, if carefully structured, trade receivables financing can be classified as a non-recourse sale of receivables which often falls outside of restrictive covenants in other finance documentation.

This is in contrast to traditional data centre securitisation, which has experienced significant cash-flow volatility, typically arising from the variation in business models and the heterogeneous nature of performance and quality indicators, cash-demanding character of the business (due to extensive capex and maintenance needs), risk of technological obsolescence and also fluctuating demand in line with customer preferences and technological advancements.

The financing of trade receivables generated by the provision of data centre related services may provide a degree of insulation from some of the typical risks and cash-flow volatility associated with data centre assets. Indeed, trade receivables financing shifts some of the investor focus away from the financed entity and places it on its clients: this may prove particularly useful for new market entrants who seek to access competitive financing while not having a significant borrowing track record. It is also a viable alternative to private equity funding, which invariably results in some loss of control over the business.

In terms of broadening access by data centre providers to different investor constituencies, few asset classes offer greater diversification, as a wide range of entities invest in trade receivables financing in the European markets, including both traditional and alternative lenders and other institutional investors.

ABCP transactions or other trade receivables securitisations may be eligible to qualify for recognition as "simple, transparent and standardised" securitisations, increasing their attractiveness for institutional investors due to the advantageous capital treatment afforded to such exposures under EU regulation. It should also be noted that the EU capital requirements framework recognises credit risk mitigation techniques such as the use of credit insurance in relation to trade receivables (provided certain conditions are met) and therefore provides further incentives for credit institutions and insurance companies to invest in trade receivables securitisation instruments.

Moreover, the credit enhancement effect generated by the use of credit insurance in relation to trade receivables finance may also supply data centre providers with a powerful tool to improve the credit profile of the trade receivables and attract funding at more competitive terms.

Trade receivables financing is not be the only way forward for financing the European data centre business. However, we are of the view it is a worthy weapon in a data centre's financial armoury. Data centre providers would benefit from looking at their trade receivables book in a new light and embracing the opportunity to unlock the value that their business already holds.


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AFRICA MARKET MAKERS 2021 CONTENTS

Finance law reforms aid move towards opening to foreign investment

Houda Sahri, Jean-Jérôme Khodara and Nahla Djabi of Matouk Bassiouny explore how the Algerian government are moving to diversify its economy, and consider the application of the 49/51 rule in detail

www.matoukbassiouny.com

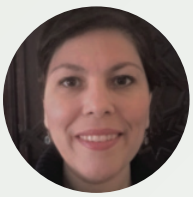
Since the beginning of 2020, Algeria has embarked on what is probably its most ambitious reform programme of its legal framework to open its market to foreign investors.

Since the issuance of the 2020 Finance Law (FL 2020) in December 2019, the Algerian authorities have removed most of the restrictions curtailing foreign investment, namely the state's pre-emption right on the transfer of shares by or to foreign shareholders, the prohibition on investors to finance their projects in Algeria with facilities from foreign lenders, and the famous '49/51 rule' pursuant to which the capital of Algerian companies must be at least 51% owned by Algerian resident persons or entities, thus limiting foreign investors' stake to 49% (the 49/51 rule).

By any measure, the 49/51 rule had become the most notorious symbol of challenges impeding foreign investment. The 49/51 rule used to be applicable across the board to all industries. The FL 2020 provided that the 49/51 rule shall apply only to purchase and resale activities and to sectors considered as 'strategic'.

Since then, other laws and regulations have been issued to complete, clarify and detail the application of such rules in addition to amend other regulations. Such restructuring of foreign investment framework is emphasised by the need of Algeria to diversify its economy and create an autonomy from the oil and gas industry, which has been the main source of income of the country in terms of hard currency. Creating a balance between opening its market and protect its fragile emerging economy, while stimulating a recovery after years of closure is the challenge facing Algeria.

In this article, the 49/51 rule is introduced, efforts to alleviate it are considered, and there is an update on the few remaining sectors to which the 49/51 rule still applies.



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Prior to founding the firm, Houda started at the Algerian Bar working in renowned Algerian law firms, and then pursued her career as the head of the legal team at KPMG Algeria. She later worked as the general counsel for Algeria at LafargeHolcim and as the MENA regional counsel at the US group, GE Power. She advises on a broad range of corporate, commercial and finance matters. She also regularly handles litigation matters, and presents cases before Algerian courts.

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Background

Since 2009, foreign ownership in an Algerian company had been capped to 49%, though companies which were incorporated before 2009 with foreign ownership exceeding 49% were exempted from the 49/51 rule. However, such exempted companies were not allowed to register certain amendments to their commercial register, including any transfer of shares, unless they comply with the 49/51 rule.

The limitation of any foreign shareholding in an Algerian company to 49% was initially introduced by the Supplemental Finance Law for 2009. The 49/51 rule was the first of a series of stringent rules introduced in 2009 and 2010 with a view to asserting the government's control over foreign investments including the state pre-emption right over any transfer of shares to or from a foreigner.

The alleviation of the 49/51 rule

The first important change to the 49/51 rule was initiated under the FL 2020, which loosened the application of the 49/51 rule. The FL 2020 provided that the 49/51 rule shall only apply to "production and service activities which are strategic for the national economy". Accordingly, the FL 2020 has transformed the 49/51 rule from a general rule to a rule of exception by means of

"Amid the Covid-19 pandemic and social unrest as result of the Hirak movement, Algeria has nonetheless successfully managed to revamp its investment framework to attract foreign investors"

limiting its application to strategic sectors.

Pursuant to the Supplemental Finance Law for 2020 (promulgated on June 4 2020, the SFL 2020) and to the Finance Law for 2021 (promulgated on December 31 2020, the FL 2021), sectors which remain subject to the 49/51 rule include importation for resale without transformation and the following strategic sectors mining, energy, defense, transport infrastructure, and pharma.

A recap is provided below for each of these sectors, together with a few other sectors which remain subject to the 49/51 rule based on industry specific legislations.

Sectors which remain subject to the 49/51 rule

Importation activities

The SFL 2020 provided that, in addition to the strategic sectors, any activity consisting in "the purchase and resale of products" shall be subject to the 49/51 rule. Such broad definition, which included both retail and wholesale activities, drew a lot of criticism.

The FL 2021 restricted the application of the 49/51 rule to companies undertaking the activity of importation for resale without transformation. Furthermore, companies involved in such importation activities which do not comply with the 49/51 rule have until June 30 2021 to do so, failing which their trade registration will be deemed void. The retroactivity of such a rule sparked a lot of scepticism and raised voices with regards to the constitutionality of such a requirement.

A draft of the Supplemental Finance Law for 2021 (SFL 2021) – expected to be passed by the end of June – dated May 3 2021 has removed the obligation to become compliant with the 49/51 rule by June 30 2021 for existing importation companies. If this removal is confirmed by the SFL 2021, existing importation companies shall be considered as exempted from the obligation to comply with the 49/51 rule which shall apply only to newly established companies.

Strategic sectors

The list of strategic sectors which remain subject to the 49/51 rule has been provided by the SFL 2020. It includes the five following sectors.

- ***Mining***: mining operations, including the exploitation of any underground or surface resources relating to an extractive activity, but excluding quarries of non-mineral products;
- ***Energy***: the upstream energy sector and any other activities falling within the scope of the law on hydrocarbons (which includes the downstream energy sector), the operation of distribution networks, the transportation of electricity by cable, and the transportation of gas and liquids by overhead or underground pipelines;
- ***Defense industry***: the military industry and related activities under the authority of the Ministry of National Defense;
- ***Transportation infrastructure***: railways, ports and airports; and
- ***Pharmaceutical sector***: the pharma industry, excluding investments for the manufacturing of essential and innovative products with a high added value, requiring a complex and protected technology and to be sold on both the domestic and export markets.

In April 2021, an executive regulation has been issued (Decree 21-145 dated April 7 2021 setting forth the list of activities considered as strategic) to set forth the detailed activities (based on the classification of the trade register) which fall within the scope of the above strategic activities (except for the defense industry).

While such clarification is very helpful, there are still some questions about the actual scope of strategic activities subject to the 49/51 rule, in particular with regards to the pharma industry. Certain criteria to exempt players in the pharma industry from the 49/51 rules can be subject to interpretation (the requirement to manufacture 'essential and innovative products') and hopefully these will soon be clarified with executive regulations.

Moreover, it is worth noting that renewable energy is not included within the list of strategic sectors. As a result, independent electricity producers would no longer be subject to the 49/51 rule. This may

"Algeria is initiating a national green energy project with an ambitious programme for the development of renewable energies and energy efficiency"

create unique market opportunities for players in the field of renewables, especially when considering that Algeria is initiating a national green energy project with an ambitious programme for the development of renewable energies (RE) and energy efficiency.

This vision of the Algerian government is based on the renewable energy programme consisting of installing a power of renewable origin of the order of 22,000 MW by 2030 for the national market, with the maintenance of the export option as a strategic objective, if the market conditions allow it.

Automotive industry

With the objective of promoting its local car manufacturing industry and preserving the country's foreign exchange reserves, the Algerian government has passed stringent legislations over the last few years in order to curb the importation of new vehicles.

In 2016, import quotas were imposed and since 2018 all importation of new vehicles has been suspended. However, Algeria's nascent car manufacturing industry is facing a crisis and the market is undersupplied in new vehicles. In order to relaunch imports, an entirely new regulatory framework for the importation and resale of new vehicles has been issued in August 2020 (Decree 20-227 dated August 19 2020, the Automotive Decree).

The main requirements under the Automotive Decree include a restriction on the importers/dealers which must be 100% owned by Algerian residents, hence foreign investors are excluded (noting that foreign investors are not subject to the 100% requirement for the distribution of cars they manufacture locally) in order to encourage local manufacturing.

It is worth noting that the scope of the Automotive Decree does not include the importation of spare parts, which is subject to a 51% Algerian ownership (pursuant to the 49/51 rule) instead of 100% for the importation of new vehicles.

The exclusion of foreign investors from the importation and resale business of vehicles is a significant concern for foreign investors in Algeria. Hence, it is not impossible to rule out that such a requirement may be lifted or softened in the short run. Furthermore, a new Minister of Industry was appointed in February 2021 with a clear mission to revive the automotive sector.

Tobacco

The tobacco industry in Algeria had been under the monopoly of the National Tobacco and Match Company (SNTA) up until 2004 (Executive decree 04-331 dated October 18 2004), when the sector was liberalised and private companies were allowed to enter the market, such as the Algerian-Emirati tobacco company (STAEM) and British American Tobacco.

The decree regulating the production and distribution of tobacco products provides for the requirement to create a partnership with a foreign with at least 51% of the capital. Interestingly, the obligation in this case is quite different as it provides for the necessity for Algerian investors to have a foreign partner for at least 51%.

It is to be noted that the government has lately examined a draft executive decree amending and supplementing the executive decree of 2004 regulating the activities of manufacturing, importing and distributing tobacco products. This draft allows national players to operate on the market without the requirement to be associated with a foreign partner.

Banking

While banking does not appear on the list of strategic sectors, it remains subject to the 49/51 rule based on regulations specific to the banking industry (Ordinance 03-11 dated August 26 2003). As state-owned banks in Algeria continue to predominate through the size of their network and their branches widely spread throughout the country, the dynamism of certain private banks in recent years has been consequent.

Amid the Covid-19 pandemic and social unrest as result of the Hirak movement, Algeria has nonetheless successfully managed to revamp its investment framework to attract foreign investors. The partial removal of the controversial 49/51 rule has been a major milestone and a positive message has been sent to investors. It is hoped that the relevant executive regulations will soon further clarify the scope of the 49/51 rule for the pharma industry and the exemption from the 49/51 rule for existing importation companies.

Changes in oil and gas sector accelerate economic diversification

José Miguel Oliveira of Vieira de Almeida and António de Sousa Penelas of ASP Advogados explain how the Angolan government has tactfully generated new economic opportunities to bounce back from a difficult financial phase

Resource curse' or 'paradox of plenty' were expressions coined to describe countries just like Angola.

Angola is among the resource-richest countries in the world, but its economy seems to be forever moving at a crawl. The reason is well-known: over the past decades, it has become so dependent on petroleum that it has neglected every other key sector. In fact, hydrocarbon production still represents over 90% of the country's exports.

Once famed for being a major global producer and exporter of iron ore, gold and copper, the industries in Angola have largely slowed. Likewise, production of coffee (there was a time when the country was single-handedly responsible for one-fifth of the world's coffee production), sugarcane and cotton, timber and paper-pulp, and processed fishing have also diminished, and Angola's exports of these products today represent close to a hand full of nothing.

The problem of putting all your eggs in one basket is just that: if something happens to the basket, there go your eggs.

Financial slowdown

When oil prices plummeted down in 2014, after years of being above $100 per barrel, Angola's economy was nearly left for dead and has been on a life support system ever since. Just when the political and financial reforms initiated in 2017 were expected to jolt the Angolan economy back to life, the Covid-19 outbreak and ensuing oil price volatility brought it to its knees again.

The pandemic has hit Angola hard. Global trade and investment dropped significantly at a time when its economy was still grappling with the sharp drop in oil prices and the production cuts ordered by the Organization of Petroleum Exporting Countries (OPEC), of which Angola is a member since 2007.

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Public debt skyrocketed to over 120% of the GDP, inflation was above 20%, the Kwanza kept devaluating fast, unemployment reached levels close to the 2006 dark economic period, and protests inevitably came to the streets.

Economic revival

The Angolan government was required to act fast, which it did. A stimulus plan including social assistance and health spending measures was cleared, a supplementary budget (using a conservative oil reference price) was approved, and a set of tax and monetary measures aimed at supporting the economy and controlling inflation were passed.

Moreover, further to the IMF's positive third review to the extended fund facility in place, the government managed to secure an additional $1 billion facility, a debt repayment suspension under the G-20 Debt Service Suspension Initiative, and delayed the country's exit from the least developed countries' list, a smart political move that allowed Angola to retain preferential access to markets and funding until 2024. Payments relief from lenders like China, whose debt is mostly made up of oil-backed loans and direct repayments, were also obtained.

Despite being focused on dealing with the impact of the pandemic, over the last 18 months, the Angolan government has stuck to its National Development Plan 2018-2022 agenda and reform programme supported by the IMF, and leveraged on its oil and gas sector to continue on the road to diversification.

Oil and gas

Major oil and gas projects poised to go live in 2020 had to be postponed, jeopardising Angola's endeavours to secure more investment for upstream exploration and development. Extra funding would have helped to prevent the decline of the country's mature offshore fields and lower production levels going forward, from Q4 2020 to date.

However, it started to seem like old times again for the local oil and gas industry, partly owing to the ongoing reform in the sector (initiated in 2018), the approval of the new local content regulations in 2020, and, of course, partly due to the rise in Brent Crude prices in the first months of 2021, averaging close to $60.

Exploration and production (E&P) developments have been gaining momentum over the past eight months.

- Total resumed drilling operations (for the first time since 2018) and announced the execution of a sale and purchase agreement with Sonangol for Blocks 20/11 and 21/09 in the Kwanza Basin, offshore Luanda;
- ExxonMobil and Sonangol were awarded risk service agreements for Blocks 30, 44 and 45 in the yet unexplored Namibe basin;
- Chevron started discussions to extend the Block 14 Consortium;
- BP started implementing its drilling program for the development campaign at Block 18 (BP's first operated development in Angola since 2012);
- ENI announced that it is going to invest $7 billion over the next four years together with its joint venture partners. BP and Eni have inclusively just announced that they are considering merging their Angolan oil, gas and liquefied natural gas assets into a joint venture in a bid to revive output, a plan that is still subject to governmental, regulatory and partner approval; and
- The Petroleum, Gas and Biofuels National Agency has recently launched an onshore bidding round for nine blocks, three in the Lower Congo Basin and six in the Kwanza Basin, as part of the 2020-2025 Hydrocarbon Exploration Strategy. These revamped production levels and

"As demand for mineral resources increases, the mining industry is a key priority in the short term"

E&P developments are definitely good news for an economy still heavily dependent on oil exports.

On top of field development, the government has also sought to improve in-country fuel supply. Although a major net oil producer, Angola still imports about 80% of all its refined petroleum products (including gasoline, diesel, aviation fuel, Jet B for gas turbines, oil fuel, asphalt and lubricants), with only 20% of refined products being sourced locally as the country has little to no refining capacity.

Three refineries with a total capacity of 400,000 barrels per day (BPD) are being built at the time of writing and the installed capacity of an existing refinery is being trebled, so one hopes that Angola will eventually produce more refined oil products than it consumes.

Lastly, Angola signed a $5 billion memorandum of understanding with its neighbour to the east, Zambia, to build pipelines between the two countries and transport gasoline, diesel, kerosene, and gas from Angola to Zambia. The project will create between 12,000 and 14,000 jobs in both countries, an important feat by any measure. The envisioned liberalisation of the downstream sector is pushing for investments: the recent deal between Puma Energy, Trafigura and Sonangol, whereby the latter sold 100% of its shareholding in Puma Energy to Trafigura and bought Puma Energy's Angolan business and assets, was anything but accidental.

Mineral resources

While pushing for its main breadwinner, the government also focused on putting other sectors on private investors' radars.

As demand for mineral resources increases, the mining industry is a key priority in the short term and new investors are particularly interested in mining mineral resources critical for the global energy transition. Moreover, the development of new technologies are sure to join the ranks of long-term diamond sector investors (in addition to diamond, Angola holds significant iron ore, phosphates, copper, gold, manganese, marble, granite, and quartz reserves, and plans to kick off niobium exploitation in Huíla province). The National Geology Plan and the 2018–2022 National Development Plan strategically focus on the mining sector and forecast a substantial diamond production increase in 2022, namely 13.8 million carats.

The sector also got a makeover with the setup of the National Agency for Mineral Resources and of the Angolan Diamond Exchange Market, and the enactment of the new Governance Model for the Mining Sector. This ensuing increased transparency in the marketing of rough diamonds has already started to attract investors to the country.

Moreover, there is a major ongoing plan for building a Diamond Development Hub in Lunda South, including four diamond cutting plants, two training centres specializing in diamond mining, valuation and cutting. A $150 million investment resulting from the partnership between Gemcorp and Endiama is also expected to enable the processing of an additional 3 million tons/year of kimberlite for the country at full production phase, by mining and processing iron and steel.

Transport infrastructure

The aviation sector has caught the eye of the government, which devised a strategy to promote the sector's growth, secure foreign direct investment (FDI) and ensure the overall sustainability of the sector, improve operational safety and bring the regulatory and tariff framework in line with best international practice. The rumours that Qatar Airways is exploring a sizable investment in troubled TAAG Angola Airlines may have something to do with this.

Moreover, the government is also committed to developing port infrastructures and logistics, having recently signed a $190 million 20-years concession agreement with DP World, the Emirati multinational logistics company based in Dubai, for the operation of the multipurpose terminal at the Port of Luanda. Other concessions and investments are under discussion, and the government is working on a new strategy to develop maritime cabotage and river transport of passengers.

Agriculture and renewable energy

The next huge step towards diversification was the approval in April of several important amendments to the existing Private Investment Law (PIL), enacted by Law 10/18, June 26 2018. The amended act grants bespoke incentives, facilities and other rights to lenders that invest in projects liable to have a structural impact on the development of the local economy and social well-being of the population, seeks to improve the country's competitiveness by generating and attracting more direct

"Green hydrogen presents another great opportunity for boosting Angola's renewable resource wealth"

investment, and creates the conditions for a more investor-friendly business environment.

Agriculture is expected to benefit the most from the amendments to the PIL. Despite the increase in agricultural production over the last years, Angola could be producing much more since only about a third of its arable land is used for crops. The country's abundance of arable land and fresh water, its location on the coast, growing population (one of the fastest in the continent), increasing demand for food and beverages, and the recent reforms made by the government with the cooperation of both the World Bank and the International Finance Corporation, of which the Program to Support Production, Export Diversification and Import Replacement (Prodesi) is an example, makes this sector extremely attractive to boost FDI initiatives.

Investment in clean energy is also expected to grow. One must recall that the Angolan government launched an extremely ambitious plan for the sector (the so-called, '2025 Angola Energy Plan'): as part of its long-term development strategy, the government aims to increase access to electricity to 60% of the population by 2025, with 70% of electricity expected to be derived from renewable sources.

To that extent, in addition to having recently revised its electricity tariff regime, implementing an energy subsidy reform, and passing new laws on procurement and electricity distribution to support independent power generation, the government has formally sought the assistance of the Sustainable Energy Fund for Africa (SEFA) to develop and implement a regulatory and institutional framework that would boost private investment in the generation of renewable energy.

The initiative would also reduce Angolan's dependence on hydrocarbons, which is inclusively aligned with Sonangol's positioning, who, committed to a responsible approach by integrating environmental, social and governance (ESG) factors in the running of its business, has recently launched a new gas and renewables unit as part of its move into the broader 'energy sector'. Rumour has it that the new regulations on power generation, transmission, distribution and marketing are likely to see the light in the near future, and investors are getting very interested.

It goes without saying that in addition to solar and hydropower, green hydrogen presents another great opportunity for boosting Angola's renewable resource wealth. If Angola can offer a robust regulatory framework, financial instruments and project financing structures that offset risks, private parties will certainly flock to the country to invest in renewable energies.

Privatisation and future opportunities

One cannot talk about Angola's future without referring to the ongoing privatisation programme (PROPRIV), where over 170 state-owned enterprises and assets will be privatised by 2022, including strategic national reference companies such as Unitel, Angola Telecom, Angola Cables, MS Telecom (telecommunications and IT), BAI, BCI and Banco Económico (banking), Ensa (insurance), Bodiva (capital markets), Sonangol EP and Endiama EP (petroleum and mineral resources), TAAG (transport), Nova Cimangola, Secil Lobito, Biocom, Cuca and EKA (industry) and Mota-Engil Angola (construction), to name a few. The PROPRIV will certainly boost the local M&A sector and contribute to increased FDI levels.

Additionally, Angola has recently executed bilateral investment treaties with Portugal, the UAE and Spain, in the hope that this will promote further investments.

With these reforms under its belt and thanks to the ongoing vaccination campaigns, Angola is certainly one of the economies in Africa better positioned to embrace the future with confidence, knowing that it is just a matter of time until investors start looking at the country as the place to be again.

Opportunities are clearly there, and investors from Europe (notably, France, Germany, Italy and Spain), UAE, and Japan are being quick off the mark in seizing opportunities in Angola, knowing that those who stay together through thick and thin will be rewarded in the time of plenty to come.

Exploring the scope of LLPs as an alternative investment vehicle

Chukwubuike Onwuzurumba and Chrysolyte Egonu of Oake Legal examine the opportunities offered to investors by the LLP structure, and look at its benefits relative to other types of investment vehicles

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Prior to the enactment of the Companies and Allied Matters Act No.3 of 2020 (CAMA 2020), investors in Nigeria were limited to the use of companies limited by shares, general or limited partnerships or private trusts as investment vehicles. The implication of this was that investors could only enjoy the benefits unique to only one type of vehicle such as limited liability (only applicable to a company) or tax transparency and structural flexibility (only applicable to a partnership).

Although the limited liability partnership (LLP) structure was, at one time, available in Lagos State under the Partnership (Amendment) Law of Lagos State 2009, its use was limited by it being a product of state law. As such, key national legislation governing investments did not recognise LLPs. These legislation include the old Companies and Allied Matters Act Cap C.20 LFN 2004 (the old CAMA), the Investments and Securities Act, 2007 and related regulations by the Corporate Affairs Commission (CAC) and the Securities and Exchange Commission (SEC).

Post-CAMA 2020

With the enactment of CAMA 2020, investors in Nigeria are able to merge the benefits of a company limited by shares and a partnership as a result of Part C, Section 746, of CAMA 2020 providing for a LLP as a body corporate with separate legal personality and with perpetual succession.

CAMA 2020 in its Part D, Section 795, has also made more specific and elaborate provisions for a limited partnership (LP) than was the case in the old CAMA. The old CAMA made provisions for a 'business name' which could be a partnership. However, business names were only registrable with CAC under certain conditions, such as where the name does not consist of the actual names of the

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partners and were not restricted to partnerships. The old CAMA did not, therefore, specifically regulate the creation and management of partnerships. This was because the Nigerian constitution made partnerships a matter for state legislation.

The legal framework for a partnership, therefore were laws passed by state legislature such as the Partnership Law of Lagos State, or the UK Partnership Act of 1890 which was applicable to some states in Nigeria as a statute of general application – a colonial era mechanism by which UK laws passed before 1900 became automatically applicable to Nigeria.

Pros and cons of companies and partnerships as investment vehicles

Generally, in structuring investments, investors would usually opt for the investment vehicle which offers the most advantages that align with their investment objectives.

A private limited liability company has the following advantages:

- It has a legal personality separate from the members;
- It has perpetual succession;
- Its shares are transferable;
- The liability of its members is limited to their capital contributions; and
- Greater access to capital and skills.

The disadvantages of a private limited liability company include that:

- It is relatively more formal, rigid and can be expensive to establish with regards to minimum capital requirements;
- It is not tax efficient because it is subject to corporate tax in addition to the personal income tax of the owners; statutory minimum capital requirements could also increase tax exposure in the form of duties payable on its instruments and which are assessed based on the value of the capital;
- Relatively higher incidence of the economic problem of principal-agent ownership as a result of ownership being separated from management – control is in the hands of those who have no stakes in the company,
- Relatively higher exposure to regulations; and
- The process of dissolution is cumbersome.

On the other hand, the advantages of partnerships are that:

- They are easy to form, less formal and flexible;
- Ownership and control are usually combined and enables quicker decision-making;
- Privacy of affairs combined with limited external regulation;
- Lenient audit requirements and tax efficiency – no tax on corporate income tax as only personal income or partners are payable; and
- Termination of partnership is not cumbersome.

The disadvantages of partnerships include that:

- There is no separate legal personality;
- In the absence of a partnership agreement, the death or exit of a partner terminates the partnership; and
- Except in the case of LLPs, the liabilities of members or some classes of members are unlimited.

Private equity firms, venture capital investors, asset managers and other investment firms in Nigeria most commonly structured their fund vehicles as LPs. This structure protected investors from liability and offered the structural flexibility and tax efficiencies of a partnership. Most investors in Nigeria however preferred to register offshore LPs, perhaps due to a relatively uncertain legal framework for LPs in

Nigeria. As noted above, there was no definitive national law for an LP. Although there are references to LPs in SEC regulations, such references did not define specific attributes or principles applicable to LPs.

LLP or LP

In considering the options of an LLP, LP or company limited by shares as an investment vehicle in Nigeria, what distinguishing factors arising from the new provisions of CAMA 2020 are relevant to an investor?

Limited liability, legal personality and perpetual succession

Generally, an LP has no independent corporate legal existence distinct from that of its partners. This is because partnership is generally based on the law of agency, with each partner becoming an agent of both the partnership and the other partners. Where the partnership is an LLP, there is the additional advantage of having a separate legal entity, limited liability for its members and perpetual succession.

In considering the options of an investment vehicle, the principle of limited liability is common to both LPs and LLPs but does not apply equally to the two structures. The liability of the general partner in an LP (usually the fund or asset manager) for the debts and obligations of the partnership is unlimited. In an LLP, Section 766 (3) and (4) of CAMA 2020 expressly provide that any contractual or other obligation of the LLP is solely that of the LLP and its liabilities shall be satisfied out of the property of the LLP.

Furthermore, the historical legal principle is that a limited partner may lose the limited liability protections if such a partner became involved in the day-to-day management of the fund or asset (now codified by Section 806 of CAMA 2020). On the other hand, a partner in an LLP does not lose the limited liability protection by becoming involved in the management of the partnership.

However, it should be noted that Section 750 of CAMA 2020 imposes a personal liability on a 'designated partner' in an LLP for any statutory penalties against the LLP for non-compliance with the law. A designated partner is specifically required by CAMA 2020 to ensure compliance with the provisions of the act or the partnership agreement. However, this form of liability is distinguishable from the liability for debts and obligations borne by a general partner. This is because the liability of a designated partner, being the statutorily appointed compliance officer, is a risk that is within the control of the designated partner and therefore can be mitigated.

The LLP structure therefore offers greater limited liability protection for the partners than those of an LP.

An LLP, having the attribute of perpetual succession, could also offer more as an investment vehicle for transgenerational wealth. Before now, transgenerational investments – whether for families in respect of descendants or businesses in respect of employees – were typically made subject of private trusts. Persons inheriting assets or income in an LLP may enjoy more statutory protection and control over the affairs of the LLP than beneficiaries under a trust.

> *"Where the partnership is an LLP, there is the additional advantage of having a separate legal entity, limited liability for its members and perpetual succession"*

Partners as agents of each other

The general rule is that the partners of an LP are deemed to be agents of both the partnership and the other partners. This is because Section 808 of CAMA 2020 provides that the Partnership Act 1890, a colonial relic incorporated as law in many states in Nigeria, is applicable to LPs registered in Nigeria. Section 5 of the Partnership Act 1890 provides that every partner is an agent of both the partnership and other partners for the purpose of the business of the partnership. In the states where the UK Partnership Act 1890 no longer applies, the state legislature has enacted partnership laws that are mostly based on the provisions of the UK law.

In the case of an LLP, Section 765 provides that a partner is an agent of the LLP but not of the other partners. This adds an extra layer of protection to a partner in an LLP against any unlawful activity of the other partners.

Contribution to partnership

The contribution required to be made by a partner in an LP is different from that required to be made by a partner in an LLP. By Section 795(4), each limited partner shall at the time of entering the partnership contribute either capital or property to the partnership. On the other hand, by Section 770 (1) the contribution of a partner in an LLP may consist of tangible, intangible, movable, immovable property or other benefit to the LLP, including money, promissory notes, other agreements to contribute cash or property, and contracts for services performed or to be performed.

Thus, whereas the contribution of a partner in an LP must be in form of either cash or property, the contribution of a partner in an LLP may be any other benefit such as time, resources, personal skills or services. The converse to this advantage is that it may raise questions as to valuation, both for purposes of initial contributions and in the distribution of income.

Investment liquidity

The capital contribution made by a partner in an LLP is more easily converted to cash than those of a partner in an LP. Section 763 of CAMA 2020 provides that an exiting partner of an LLP (or a successor-in-title in the case of death) is entitled to the amount equal to the partner's capital contribution or a share of the net profits of the LLP.

The converse is the case for a partner of an LP. Section 795 (5) of CAMA 2020 provides that a limited partner cannot draw out or receive back the partner's contribution while the partnership continues to exist. Where the partners draw on the contribution during the life of the partnership, such limited partner becomes liable for the debts and obligations of the partnership up to the amount drawn.

In practice, LPs resolve this limitation by typically structuring the investments of the

"By Section 795 of CAMA 2020, an LP cannot have more than 20 partners. An LLP therefore can pool more investors than an LP"

partners as a debt rather than a contribution (or making the contribution a token sum).

Number of partners

CAMA 2020 does not provide a limit to the number of partners in an LLP but provides for a minimum of two partners. By Section 795 of CAMA 2020, an LP cannot have more than 20 partners. An LLP therefore can pool more investors than an LP.

Winding up and dissolution

The provisions for winding up and dissolution of an LP are not elaborate. By Section 806 (3), except otherwise ordered by the court, the affairs of an LP shall be wound up by the general partners. This implies that the court may be involved in the winding up of an LP. It does not however disclose the circumstances under which an application may be made to the court to wind up an LP.

This is not the case for an LLP. By Section 789, the winding up of a LLP may be either voluntary or by the court. Section 790 outlines six grounds under which an LLP may be wound up by the court. This provides clarity and protects against arbitrary actions of any partner.

Implication of registration – wider range of lawful activities

By Section 756, the implication of registration of an LLP is that it can sue and be sued in its name, it can acquire, own, hold and develop or dispose of property, whether movable or immovable, tangible or intangible. An LLP may have a common seal and it can do and suffer such other acts and things as bodies corporate may lawfully do and suffer. This is not the case for an LP.

Transfer of rights

By Section 774 (1), unless otherwise provided in the LLP agreement, the rights of a partner to a share of the profits and losses of a LLP and to receive distributions in accordance with the LLP agreement are transferable either wholly or in part. This provision allows for the transferability of rights in an LLP in the same way obtainable in limited liability companies.

Although this comes with restrictions in that by Section 774 (3), the transfer of a right does not, by itself, entitle the transferee or assignee to participate in the management or conduct of the activities of the LLP, or grant access to information concerning the transactions of the LLP, nonetheless this will be an attraction for investors who may want to exit the partnership and sell their stake in it.

This provision on transfer of rights is not ordinarily available to an LP. It should be noted, however, that the structuring of investments as debt to the LP also enables the transferability of debt in accordance with the legal principles applicable to property.

Statutory filings and disclosure requirements

By Section 772, an LLP is required to maintain a proper financial and accounting system. This includes the maintenance of proper books of accounts, statements of accounts and solvency and conduct of periodic audits.

By Section 773, an LLP is required to file its annual returns. These finance control measures will be a source of attraction for prospective partners who may want to know the state of affairs of the partnership and reduces information asymmetry. It also serves as a source of comfort to non-active partners who can monitor the growth and performance of the partnership.

Caveat

For all its benefits, an LLP may be potentially limited unless an investor exercises some basic precaution. CAMA 2020 devolves many issues to the partnership agreement. While this is an advantage by the nimbleness it offers to investors, it also creates a need for a careful negotiation of terms to ensure proper risk allocations and protections for investors. A non-exhaustive list of key headline terms to consider carefully are:

- Valuation principles and mechanisms – of non-cash contributions and any future reward or incentive scheme for partners including bonuses and fees;
- Management and day-to-day control in order to ensure the limited liability principle does not create a moral hazard on the part of management;
- Number of partners; and
- Appointment (and rotation?) of designated partners.

A growing trend for investors

The LLP structure was traditionally the preferred mode for firms in the (professional) services sector. However, it has increasingly become attractive as the investment vehicle for private equity and venture capitals firms or other investors generally. LLPs enable investors to take advantage of the benefits of limited liability applicable to companies and the tax transparency and structural flexibility of a partnership structure.

Unlike a limited liability company, LLPs will not be subject to corporate tax as only the personal income of the partners from the LLP will be taxable. Also, unlike a general or limited partnership, the liability of all the partners is limited to their individual contributions irrespective of a partner's involvement in management of the partnership. LLPs can also enjoy flexibility in their structuring as Section 762 of CAMA 2020 allows the partners to determine their mutual rights and duties by agreement between the partners or between the LLP and the partners.

While some jurisdictions have sought to limit the use of LLPs as investment vehicles, no clear reason has emerged for this reluctance in those jurisdictions.

Further reforms

With the coming into effect of the CAMA 2020, further legislative reforms may be needed to harmonise the various investments laws in Nigeria in line with CAMA 2020.

The consolidated Rules and Regulations of the Securities and Exchange Commission (the Rules), for instance, may require amendment to acknowledge the new legal entities created nationally by CAMA 2020. Specifically, Rule 555 of the Rules stipulates that a mandatory provision of a partnership agreement is that a fund provider shall be a limited or non-active partner. The provisions of CAMA 2020 has clearly expanded the limits of a partnership structure for investments through the creation of the LLP structure.

A closer look at the Investment Act of 2021

Mahmoud Bassiouny, Yassir Ali, Nadia Abdallah and Amad Nagy of Matouk Bassiouny consider how Sudan's new investment law is set up to help facilitate greater investment from domestic and international sources

www.matoukbassiouny.com

The Republic of Sudan is moving forward to attract the attention of national and foreign investors. On December 14 2020, Sudan was officially removed from the US's 'State Sponsors of Terrorism' list. This was further followed by an announcement from the President of France, Emanuel Macron, of the cancellation of $5 billion from Sudan's debt on May 17 2021.

In light of the improvement of the Sudanese national economy, Sudan has published several new legislations to set out a more flexible and effective legal framework. This includes, among others, the new Investment Encouragement Act, 2021 issued on April 11 2021 (the New Investment Act) cancelling the previous Investment Act, 2013 (the Old Investment Act), the Public Private Partnership Act, 2021, and the new Banking Act, 2021.

The New Investment Act introduces new provisions, establishes additional investment authorities, and adopts advanced concepts as explained below. The New Investment Act maintains the following types of projects, which were regulated under the Old Investment Act, while providing further clarification in relation to the definition of each of them:

- **State project**: any investment project established in Sudan in accordance with the requirements set forth by the newly established Investment and Private Sector Development Authority (Authority) in which the conditions of the national project do not apply;
- **Investment project**: any economic activity licensed by virtue of the New Investment Act;
- **National project**: any cross-border investment project between different Sudanese states which is based on the investment, exploitation of the natural resources, or underground national resources, or participated in by the state, which affects the domestic communities, or controls strategic products and services of the state including, foreign investment; and

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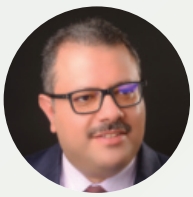

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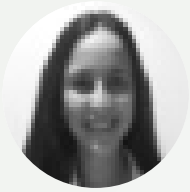

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Nadia has worked on multiple matters in connection with companies' law relating to the establishment of corporate entities, giving advice on daily matters, organising and drafting the minutes of meetings and drafting various contracts depending on the needs of the client, in addition to project finance and banking.

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- **Strategic project**: a project established by virtue of an agreement with the government of Sudan.

The New Investment Act aims to prepare the investment environment to attract investments in line with the targets and priorities of Sudan, as well as increasing the economic growth rate, creating job opportunities, and exploiting natural and human resources.

In light of these purposes, investments projects shall follow the general principles provided under Article 5 of the New Investment Act. Among others, this includes meeting the needs of the local and regional market, supporting and developing entrepreneurship, creativity, as well as emerging, small, and medium companies, in addition to protecting the environment and public health, and encouraging scientific research and using modern technology in different production sectors.

New investment authorities

The Authority

The New Investment Act establishes the Authority for Investment, Development of Private Sector and Units subject to the Supervision thereof (the Authority) which enjoys most of the competences previously vested in the High Authority established under the Old Investment Act. The Authority shall be constituted by virtue of a Prime Minister decree and headed by the Minster of Investment, and shall supervise the following units:

- The investment encouragement and progressing investor services unit;
- The public and private sectors partnership unit:
- The market and free zones unit: and

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- The leading small and medium companies (Article 6).

The Authority is the supreme authority in charge of investments-related matters. Its powers, which are listed under the New Investment Act, include, without limitation:

- Approving the general policies, strategies, plans, and programs required to achieve investment purposes and following up on the execution thereof;
- Revising laws related to investment; and
- Cooperating with the investment-related authorities (Article 7).

The Operation Rooms

The New Investment Act provides that the Minister of Investment shall establish:

- The 'Investment Lands Operation Room' for the purposes of cooperating with the relevant Sudanese state to determine the lands designated for investment; and
- The 'State Investments Operation Room' to cooperate between the Ministry of Investment and foreign cooperation (Ministry of Investment) and the Sudanese states to achieve the purpose of national investment (Articles 13 and 14).

The Insurance Guarantee Company

The New Investment Act provides for the incorporation of a company to guarantee insurance of national and foreign investment (the Insurance Guarantee Company) in accordance with the Companies Act of 2015. The purpose of the Insurance Guarantee Company shall include insurance against:

- The risk of currency conversion;
- The risk of confiscation and nationalisation:
- The risk of war, social dispute, and civil rebellion;
- The risk of terminating a contract in violation of the law; and
- Non-commercial risks pursuant to the relevant international conventions (Article 27.1).

The insurance of a project may be undertaken by the investor in consideration for annual instalments fixed under the company's articles of association. The Ministry of Investment may participate in the insurance through instalments fixed pursuant to its discretionary power, such participation is made by the means of a set-off through deduction from the obligations of the project toward the state of Sudan (Article 27).

The Insurance Guarantee Company has the right to proceed with reinsurance activities with international Arabic institutions, in which Sudan is a party (Article 27.3).

Investment incentives and social liability

Investment incentives and privileges

All investments in Sudan enjoy fair and equitable treatment. Investment projects that ascertain economic interests benefit from, among others, the following privileges.

Privileges

Foreign investors enjoy accommodation in Sudan for the duration of the project. Further, no fees shall apply on projects except by virtue of an approval of the Ministry of Investment. Accordingly, the Ministry of Investment shall fix the fees thus promoting competition between investments in Sudan.

Customs and taxes exemptions

The New Investment Act provides for an exemption from the following customs duties: (i) the fee applicable to the capital required for the setup and preparations of a project; and (ii) on specific transportation as determined by the regulations.

Furthermore, an investment project is exempt from business profit tax for a period not exceeding five years from the commercial production date in accordance with the regulations. It is expected that the exemption period will be fixed on a case-by-case basis within the limit of five years from the commercial production date. The investment project is also exempt from value added tax (VAT) in accordance with the list approved by the Ministry of Investment.

Allocating the land

The Investment Lands Operation Room shall prepare the project land in cooperation with the Sudanese states, and fix the general and specific requirements of each project with regard to allocating the project land. The duration of contracts over investment lands is three years subject to renewal with the license as determined by the regulations.

Preferential incentives

The Authority may grant additional privileges for projects in accordance with the regulations. Such privileges are subject to the fulfilment of the determined timeline for project execution.

Social liability

The New Investment Act innovates the concept of social liability. An investor may allocate a percentage of the annual dividends of a project to participate in social development, which amounts will be deducted from the investor's tax base. The type and scale of social liability is determined upon the issuance of the license (Article 28).

Given the voluntary language of the New Investment Act regarding the allocation of a percentage of the annual dividends to participate in the social liability, it is presumed that the determination of the social liability type and scale under the license will occur following the approval of the investor to participate thereto.

The New Investment Act lists the domains in which an investor may participate including:

- Protection of the environment;
- Healthcare, social, cultural, or any other development services
- Training and scientific research; and
- Any other field as agreed with the competent authorities.

The Minister of Investment may, in cooperation with the relevant ministries, issue a list of the best projects which undertake social development activities.

Licensing regime

Granting the license

The New Investment Act allows any person to undertake an investment project upon obtaining the required licenses. In the case of national projects, negotiations shall be held with the relevant state. The license duration is three years subject to renewal following the fulfilment of the required information in accordance with the regulations relating to the New Investment Act, noting that such regulations have not yet been issued. Failure to execute the investment project within the duration of the license would result in cancellation of the license (Article 23).

Investment-related ministries and regions (the competent bodies) have the right to issue a preliminary approval in respect of the establishment of a project on the basis of a technical, economic, and social feasibility study, as well as following up on the execution of the project and reporting periodically to the to the Ministry of Investment (Article 10).

The one-window system

The one-window system, which was created by the Old Investment Act in order to facilitate the services provided is maintained under the New Investment Act. The one window system covers all Sudanese states, in addition to including coordinators from the competent ministries and governmental units related to investment (the investment coordinators) (Article 9). The investment coordinators shall have the same powers of the entities they represent, and shall be competent to undertake a technical review of the licenses requests (Article 11.3).

Investment limitations

General limitations

The investor may not, except upon the approval of the Minister of Investment, undertake any of the following (Article 24):

- To amend the project size, the purpose for which the license was granted, or changing the site of the project specified in the license as approved by the competent bodies;
- To use or sell the equipment, machinery, material, or transportation means which enjoyed privileges for any a purpose other than that specified in the license;
- To create a pledge over the project, equipment, machinery, or transportation means in order to acquire financing for the project;
- To dissolve the partnership or transfer the ownership of the company;
- To dispose of the land granted for the investment project whether by sale or pledge except after it is fully invested in accordance with the regulations. It is expected that the regulations to determine the criteria of 'full invested' project will be confirmed, as it is not specified under the New Investment Act (e.g. full construction of the project is completed, or the elapse of the license duration etc.); and
- To divide an investment project by any means.

Limitations on foreign investments

The New Investment Act provides that the Authority shall, on the basis of the recommendation of the Minister of Investment, issue a list including certain sectors and economic activities which are not subject to foreign investment. Given the novelty of the New Investment Act, such a list has not yet been issued.

It is worth noting that the New Investment Act refers to the unissued regulations with regard to fixing minimum capital requirements for foreign investors (Article 22.1). The Authority is competent to issue regulations required to enforce the provisions of the New Investment Act, which regulations have not yet been issued (Article 39.1).

Prior to obtaining the license, a foreign investor must pay an amount not less than $250,000 or its equivalent of the foreign currencies admissible by the Central Bank of Sudan as evidence of commitment in accordance with the regulations. It is expected that the regulations will specify the relevant authority to which the investor is entitled to pay such amount, given that it is not determined under the New Investment Act. Such an amount will be used to finance the relevant project after obtaining the license (Article 22.2).

Dispute resolution

Dispute resolution mechanism

The New Investment Act maintains:

- The dispute resolution mechanism provided under the Old Investment Act, whereby any dispute in relation to an investment shall be settled by the competent court unless the
- parties agree to arbitration or conciliation, to the extent the dispute does not fall under the umbrella of the conventions stated under Article 34.2 of the New Investment Act (e.g. the Investment Disputes Settlements Raised Between the Arab States Convention of 1974); and

The principle for the establishment of competent courts by the head of the judiciary, and competent public prosecutions by the public prosecutor for the violations in relation to investments, as already provided under the Old Investment Act (Article 33 and 34).

The New Investment Act creates a plaint mechanism which was not tackled under the Old Investment Act. A 'plaint committee' shall be established by the Authority to examine the complaints regarding the decisions issued by virtue of the New Investment Act. The plaint committee shall issue its decision in relation to the complaint within a period not exceeding three weeks from the date of receiving the complaint (Article 38).

Violations and penalties

The Minister of Investment has the right to impose the following penalties (to be registered under the 'investment register' of the investment project) in case of violation of the provisions of Article 23 or 24 of the New Investment Act in relation to granting licenses and the general limitations on investment elaborated above (Article 37):

- Serving written notice requesting the cure of the violation within the period specified in the notice;
- Total or partial deprivation of the privileges and exemptions granted to the violator in accordance with the regulations;
- Suspension of works until the violation is cured;
- Cancellation of the license in case of violation of the provisions of the New Investment Act, the regulations issued pursuant thereto, or the licensing conditions; and the
- Cancellation of the license in case of suspension of the activities or business performance of the investment project for a period exceeding one year without notifying the Authority, or delay for a period exceeding one year from the date of the operation under the timeline submitted by the investor when requesting the license without an acceptable excuse.

New security regime over movable assets creates further transparency

Jirayr Habibian of Matouk Bassiouny assesses the key takeaways from the executive regulations implemented for the new movable pledge law in the UAE

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The UAE in 2020 issued Federal Law 4 of 2020 (the new law) that repealed and replaced Federal Law 20 of 2016 (the old law) on securing interests over movable assets. Following the enactment of the new law, the UAE Cabinet of Ministers issued Decree No. 29 for 2021 regarding the executive regulations for the new law.

Despite the publication of the new law, the essential elements of the old law has largely been retained in most cases, with a few additions that will facilitate the creation of a better suited legislation.

The new law brings the following notable differences.

Scope of application

The old law applied to contracts and security interests over movable tangible and non-tangible assets.

The new law retains the same principle over taking security interests over movable tangible and non-tangible assets, for the present and in the future. It also adds that transferees' rights, with respect to the same of account receivables, shall be treated as a security right.

The executive regulations

The executive regulations mainly deal with the registration procedures on the Emirates Movable Collateral Registry (the EMCR). Although the new law provides for a new registry to be created, the executive regulations did not introduce a new registry, hence the EMCR continues to be the applicable forum for registering security interests.

It should be noted that the EMCR has altered its name – and has introduced changes to its website – to become the Emirates Integrated Registries Company (EIRC).

Type of assets

The old law lays down the various types of assets that could be subject to a mortgage, including current and future

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Jirayr is a graduate of St Joseph's University Law School and Montpellier University.

movable properties, such as:

- Account payables;
- Payables and deposits at licensed banks and financial institutions including current accounts and deposits accounts;
- Bonds and other documentation that make ownership transferable through delivery endorsement, commercial papers, certificates of deposits, bills of lading and warehouse bonds;
- Work equipment and tools;
- Material and moral elements of a business falling under the commercial transaction law and the trademark law;
- Raw materials, goods intended or sale or lease and goods used in the manufacturing process; and
- Any other movable asset that may be considered to be valid under the federal law.

The new law has retained most of the assets referred to above, however, the old law did not cover the accounts receivables. The new law covers that point by giving a definition of the account receivables, being a right to receive any such amount that the third party may owe the pledger. Under the new law, accounts receivables are now covered and security interests would be possible.

The new law has clarified the types of assets that may not be pledged or secured under the provisions of the law and has narrowed down these assets under the following three heads:

- Movable required by law to be registered as security rights in relevant registries;
- Wages, salaries, expenditure and compensation for workers and employees; and
- Public funds, endowment funds, foreign diplomatic funds and funds of international governmental organisations.

Enforceability of secured rights vis-a-vis third parties

The executive regulations provide that security rights over accounts (only the accounts, and not other types of assets) can be enforceable against third parties by way of control. This is established:

- Automatically if the right is over an account which is held by a financial institution; or
- If the security provider, secured party and financial institution holding the account, sign an agreement establishing the secured party's control over the account.

The executive regulations mandate a specific form of a notice that is to be served when a secured creditor exercises his rights against the collateral directly.

Right to access the register

The new law provides the public with the right to access the information. The same can be requested in soft or hard copy format, as per the practice existing under the old law.

Priority rights

Article 17 of the old law announced the principle by virtue of which the declaration of a mortgage by the mortgagee entitled them to rights over other creditors in fulfilling their rights over the mortgaged property. This priority was subject to the date and time of the said declaration.

The new law however complements the old law by retaining the existing principles but clarifying certain other aspects, as follows:

- Priority rights shall be granted to all secured liabilities including the ones that rise after they become enforceable;
- Security rights established under the law shall not be affected any other competing rights that may come to the notice of the mortgagee; and
- The implementing regulations shall take precedence over any and all other priority rules that may affect particular types of mortgages.

Taking into account the imposition of the control methods for bank accounts, the executive regulations set out a priority waterfall for credit accounts with the bank holding the account and security ranking first, followed by those with a control agreement and others.

The securities registered as per the old law

The executive regulations have clarified that security interests granted under the old law regime shall remain in force vis-a-vis third parties, only after the registration of such securities with the emCredit database, and in accordance with the provisions of the new law. It shall remain valid until expiry.

Article 48 of the new law provides that a secured party could register a security interest that was originated prior to the issuance of the executive regulations, provided that the registration is effected within six months from the date of enacting the executive regulations.

The provisions of Article 48 of the new law, combined with the provisions of the executive regulations, would lead to the conclusion that any security interest granted under the old law but not perfected prior to the issuance of the executive regulations needs to be registered in accordance with the new law, however, the priority ranking will still be considered under the old law (the date of the registration of any event).

In conclusion, the new law and the executive regulations have come to introduce a holistic security system over movable assets with wider application related to account receivables and bank accounts, which grant better and more transparent security for creditors against their debtors.

CHINA OUTBOUND INVESTMENT SPECIAL FOCUS 2021 CONTENTS

LUXEMBOURG

FRANCE

Optimistic outlook for Chinese investment into Luxembourg in post-Covid times

Marcus Peter and **Kate Yu Rao** of **GSK Stockmann** explain why the outlook for Chinese investment into Luxembourg remains positive, despite the temporary change in investment conditions due to Covid-19

www.gsk-lux.com

Since the first opening of the overseas subsidiary of Bank of China in Luxembourg in 1979, the Grand Duchy has become a gateway to the EU for Chinese financial institutions and more generally has been brought into the sight of Chinese investors as the subsidiary of Bank of China in Luxembourg and the EU hubs of other Chinese banks which have been set up in Luxembourg in a later stage serve China-based investors that wish to invest in Europe.

The overseas subsidiaries of the Chinese banks have also expanded into capital market activities in Europe alongside asset and wealth management, and are actively involved in financing M&A deals which are originated by Chinese investors.

In 2011, the Luxembourg Stock Exchange (LuxSE) listed the first offshore RMB bonds, better known as Dim Sum bonds, issued in Europe. Since then the exchange between China and Luxembourg has experienced rapid growth, which led to fact that when Chinese investors plan to list renminbi (RMB) bonds in continental Europe today, the LuxSE is a natural choice.

Luxembourg is a pre-eminent hub within the EU for financial services activity connected to the Chinese market, and it is well positioned to act as a bridge into the RMB investment pool; as it has been doing for many years.

According to the OECD data, global foreign direct investment (FDI) flows dropped to $846 billion which corresponds to a decrease of 38% in 2020, the lowest level since 2005, as a consequence of the Covid-19 situation. The Covid-19 pandemic also posed several challenges to the economy of Luxembourg. Investments in Luxembourg dropped considerably until mid-2020 alongside a global slowdown due to Brexit and the Covid-19 crisis.

In order to respond to the financial disadvantages caused by the Covid-19, the Luxembourg government established a financial support scheme for the companies which are in

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temporary financial difficulty, and implicated a series of tax measures to support companies with regards to direct and indirect tax payments. Recovery could be observed with a slow, but stable pace in the second half of 2020.

By May 2021 the situation looks much better seeing GDP growth and also an increase in tax revenues. Insolvency rate was lower than expected and the economy is getting stronger again. The unemployment rate has also decreased to around 6%. The outlook is positive with Covid-19 figures declining strongly.

Ease of investing

In December 2020, the EU and China reached an agreement in principle on investment that places an emphasis on providing access to the Chinese market for European investors. Ensuring fair treatment for EU companies in the Chinese market and enabling more cross-border deals between the EU and China, the agreement shall support a better balance in the EU–China trade relationship. The framework is likely to also play a key role in helping the Luxembourg and EU markets to recover.

However, the ratification of the agreement might face problems with the EU sanctions on China enforced in March 2021 over concerns about the human rights situation in Xinjiang and the Chinese counter-sanctions. As a result, the influence of the agreement remains uncertain.

As regards practical considerations for making investments in Luxembourg, in general no specific pre-approval process for M&A transactions exists but the deals may be subject to a posteriori approval process by the competent Luxembourg authority. Nevertheless, new EU regulations (Regulation (EU) 2019/452) on FDI entered into force in May 2019.

Under these new regulations, EU member states are required to inform the European Commission and other member states of any FDI review. Even though Luxembourg itself does not conduct any FDI reviews, it will still be subject to this review process under the new regulations.

As regards the merger clearance process, the Luxembourg law of October 23 2011 on competition designated the Competition Council as the competent authority to scrutinise and analyse mergers and acquisitions taking place in Luxembourg and involving Luxembourg entities. Although it is a post-closing merger clearance process, the Council has indicated its readiness to encourage market participants to run a pre-merger control check where feasible. This possibility therefore exists for investors looking to acquire a Luxembourg-based target.

As for the restrictions on investment, specific rules may apply in certain sectors. For example, in acquisitions in the financial sector (e.g. banks or asset managers), an investor must notify its intention to acquire a certain threshold in a Luxembourg bank or financial sector entity to the regulator, the *Commission de Surveillance du Secteur Financier* (CSSF).

The CSSF has the right to oppose the transaction based on reasonable grounds and certain legal criteria. Other restrictions apply in certain industries or on acquisitions of companies with securities admitted to trading on a regulated market in Luxembourg where the CSSF, being the competent authority, shall supervise bids impartially and independently of all parties to the bids. The related rules are established by the law of May 19 2006 implementing Directive 2004/25/EU on takeover bids, as amended (also known as the Takeover Law).

Generally, the abovementioned rules apply to Chinese investors and investments, and there are no currency restrictions and no specific contractual provisions arise in relation to Chinese investment.

Investment structures

The most common legal entities used for Chinese investment into Luxembourg are private limited liability companies (i.e. *société à responsabilité limitée* or SARL) or public limited liability companies (i.e. *société anonyme* or SA). Both are commonly used as structures for acquisition of companies.

The SARL has a lower minimum share capital and seems to be favoured over the SA. As regards to investment activities by funds established by Chinese investors in Luxembourg, the most common structure seems to be the reserved alternative

investment fund (RAIF), and also, to a certain extent, the specialised investment fund (SIF). Both are set up as limited partnerships in the form of *société en commandite simple* or *société en commandite spéciale*. In addition, an investment company in risk capital (i.e. *société d'investissement en capital à risqué* or SICAR) is also commonly used by investors including Chinese investors to pool money for investment.

The key requirement for setting up and using any of these vehicles is the establishment of a certain entity in Luxembourg with sufficient substance. A minimum share capital needs to be provided to the Luxembourg vehicle and management procedures need to be put in place. More specifically, a majority of the management members of the vehicle shall be Luxembourg resident and regular board meetings shall be held in Luxembourg, to ensure decisions are made in Luxembourg.

In establishing investment funds that carry out M&A activities, investors must verify that these comply with the regime of alternative investment fund managers and obtain the applicable approvals from of the CSSF. While RAIFs are not subject to CSSF approval, the SIF and SICAR investment vehicles must be pre-approved by the CSSF before they can begin their business activities.

Dispute resolution

The most commonly used dispute resolution mechanisms are court litigation and arbitration.

Arbitration is generally favoured by foreign investors because arbitral awards are easier to enforce than court judgments, more flexible and provide more privacy. By 2020, Luxembourg was party to over 100 bilateral investment protection treaties including a treaty with China, the latest version of which entered into force in 2009. Luxembourg's arbitration courts are used to international agreements, given Luxembourg has been increasingly used as a platform for cross-border investments, joint-venture vehicles and investment funds carrying out M&A activities worldwide.

As regards litigation, Luxembourg courts typically review disputes in a neutral and independent manner within a normal duration of time and issue titles for enforcement useable in Luxembourg and abroad as far as other jurisdictions are covered under respective regulations and treaties.

One of the most important pieces of regulation in this respect is the Recast Brussels Regulation: Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of December 12 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

Another is the Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (also known as the Lugano Convention). Local civil procedure code and case law are also of importance.

However, parties in Luxembourg tend to solve their disputes outside arbitration and courts. This is to maintain confidentiality and enable a smooth continuation of business in Luxembourg.

Fund structuring

Regarding taxation, Luxembourg benefits from an extended network of double taxation treaties advantageous for FDI into and out of Luxembourg. By applicating the European parent/subsidiary directive, typically no withholding tax applies on dividends. The corporate income tax rate in Luxembourg is 17%. No specific FDI tax incentive schemes are in place, nor are there any specific reciprocal tax arrangements between Luxembourg and China.

On March 21 2020, the Luxembourg parliament passed a law implementing Council Directive (EU) 2018/822 of May 25 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (also known as the DAC6 Law), which introduces a new obligation for intermediaries to disclose to the Luxembourg tax authorities any cross-border arrangements that meet a hallmark and is expected to also have an impact on cross-border M&A structuring by Chinese investors. The DAC6 Law entered into force on July 1 2020.

On October 14 2020, the Minister of Finance of Luxembourg submitted the draft budget law for the year 2021 (Draft Budget Law) to the Luxembourg Parliament, which, among other things, proposes to introduce a 20% withholding tax on income deriving from real estate located in Luxembourg held by certain Luxembourg investment funds directly or through transparent entities or common funds. The Draft Budget Law was adopted by the Luxembourg parliament on December 17 2020 and entered into force on January 1 2021 (for most of the tax measures).

In relation to the Covid-19, Luxembourg's Ministry of Finance announced on March 17 2020 the relaxation of certain tax payment deadlines for companies and self-employed individuals affected by the Covid-19 outbreak.

Taxpayers experiencing liquidity problems are entitled to ask fora cancellation of advance tax payments for the first two quarters of 2020. Additionally, the same categories of taxpayer will be given up to four months to pay certain taxes due after February 29 2020, without incurring late payment interest charges. These measures provided more relaxation in terms of cash flows for Chinese investors coming in and having business Luxembourg during the Covid-19 pandemic.

Outlook

The outlook for Chinese investment into Luxembourg remains optimistic, despite the slowdown in Chinese FDI into the EU and the temporary change of investment conditions due to Covid-19, as we are of the opinion that legal and political stability of Luxembourg's regulatory and legislative framework, as well as growing fund industry and financial sector, are still the main considerations for Chinese investors to make investment decisions even during pandemics.

Investments focusing on certain sectors, such as consumer goods and infrastructure, are more likely to attract attention and interests from Chinese investors. Nevertheless, environmental, social and governance (ESG) and green investment is going to be a major topic and one big potential growth in terms of opportunities going forward.

Chinese government has been more and more encouraging sustainable investment practices and prioritising ESG factors in overseas investment, since the 'Belt and Road Initiative' was incorporated into the Constitution of China in 2017.

A trend where ESG factors and consideration will play an important part in investment decision making is expected, and Chinese investors will need to consider ESG standards in evaluating outbound investment opportunities in Luxembourg and the EU. Expertise in asset management relating to China and strong levels of early movement in green finance marks Luxembourg's position as a hub for supporting green investment flows from China to Luxembourg.

France is well positioned for a strong post-Covid rebound

Chinese investment into France held steady in 2020 while it dropped across the rest of Europe. **Raphaël Chantelot, Ran Hu, Fanny Nguyen, Hubert Bazin** and **Nicolas Vanderchmitt** of **LPA-CGR avocats** review the jurisdiction's investment advantages

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As one of the largest economies in Europe, with developed infrastructures, a central geographical position and a stable political system, France is one of the most popular destinations for foreign direct investments (FDI) in Europe, with a variety of targets ranging from luxury goods to food specialties, from fashion to high-tech companies.

Following the election in 2017 of a new, business-friendly president, Emmanuel Macron, a series of reforms have been implemented to make France more attractive to foreign investors. For instance, the government of President Macron has decided to gradually lower the French corporate income tax rate to 25% by 2022 (from more than 33.3% in 2017), to develop tax incentives for innovation (such as a strong R&D tax credit system).

Major changes have also been decided to make French labour law more flexible, with a simplification of the employees' representation system and clear rules for terminating employees (reducing both the severance cost and the risks of litigation).

Chinese investments in France: key figures

Despite the impact of the Covid-19 crisis, that stalled a number of projects, China remained the leading Asian investor in France in 2020, with 53 projects recorded, creating or maintaining nearly 1,700 jobs (up 24% from 2019).

Chinese investment in France targets all kinds of sectors and types of businesses, from family businesses to listed groups (for example, Lanvin, Accor Hotels), in industries as diverse as tourism (Club Med), fashion brands (Baccarat), food and wine, football clubs, the automotive sector (listed car parts manufacturer Le Belier), among many others.

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In 2020, France was the leading European location of job-creating investment from China, receiving 26% of Chinese investments in Europe, ahead of Germany (17%) and the UK (13%). To date, there are over 900 subsidiaries of Chinese businesses established in France, where more than 50,000 people are employed. Chinese direct investments in France amounts to an aggregate €8.5 billion (approximately $10.3 billion) (cumulated FDI inventory).

The outlook for Chinese investment in France remains promising. Indeed, despite the effects of the Covid-19 crisis, foreign businesses established in France are not currently considering curbing activities in France, and although certain projects have been postponed, many opportunities can be seized.

Much restructuring and M&A activity is expected, as a lot of French companies will want to refocus on core business and divest other activities, and many other companies will be looking for new investors to bring much needed financing.

France is also benefitting from Brexit, as the UK was previously one of the preferred investment destinations in the EU, and from the rising trade tensions with the US, which traditionally absorbed one of the largest chunks of Chinese FDI.

These circumstances, combined with the positive effects of President Macron's reforms, make France a desirable entry point for Chinese investors looking to develop operations in Europe.

French foreign investment controls

As a principle, foreign investment in France is free and not subject to governmental approval. However, in certain industries which are deemed sensitive or related to national defence, a prior authorisation from the French government may be required.

French law (Section L.151-3 of the French Monetary and Financial Code) traditionally provides that certain foreign investments in activities relating to national security or critical for public safety are subject to prior approval by the French Ministry of Economy.

The French government has been extending the list of industries deemed 'sensitive' to the French economy and subject to prior approval. The list now includes, for instance, investments in telecom, transportation or public health (with the addition of 'biotechnologies' as a result of the Covid-19 crisis), or technologies with a dual use (civil and military), certain IT and telecom areas (robotics and artificial intelligence, cryptology, communications and transportation networks and services).

The requirement for prior approval applies to investments made both (i) by investors registered in the EU or the European Economic Area (EEA), when they take control of a company active in these industries; and (ii) by investors from other jurisdictions (outside the EU/EEA), when they acquire more that 25% of the share capital and voting rights of a company active in such 'sensitive' industries.

As a temporary response to the Covid-19 crisis, the French government has extended its control to investments in listed companies (for those active in these industries) when they exceed 10% of the voting rights.

The authorisation process, however, is quite straightforward: the request is submitted to the Ministry of Economy, which has one month to review the investment and approve it or request additional information (in which case its

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Since 2006 Hubert has been involved in the preparation of the Ricci Dictionary of Chinese Law (first trilingual Chinese-French-English legal dictionary).

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review must be completed within 45 days of the application). In practice, longer review periods, such as three or four months, should be anticipated if the Ministry of Economy requests supplemental information and considers imposing conditions to clear the case.

It should be noted, however, that a new EU Regulation 2019/452, which came into force at the end of 2020, adds a new layer of foreign investment control. Under this new regulation, in the course of its review, the French Ministry of Economy must notify the foreign investment project to the EU Commission and other member states may request that specific conditions be added where the contemplated foreign investment can also have an impact in their jurisdiction on their own public safety or public order.

There are no foreign currency or foreign exchange restrictions in France.

Antitrust

In terms of competition policy, the French authority that oversees competition clearance is the French Competition Authority (*Autorité de la Concurrence*), an independent administrative agency.

French merger control applies if the turnovers of the parties to a transaction (the acquirer, the target and their subsidiaries) exceeded, in the last financial year, certain (cumulative) thresholds provided in Article L. 430-2, I of the French Commercial Code. The thresholds include a worldwide turnover by all parties exceeding €150 million or a turnover in France exceeding €50 million for at least two of the parties. Transactions are not subject to notification in France if they are notified at the EU level.

Under Article L. 430-3 of the French Commercial Code, a notifiable merger

cannot be finalised before it is cleared by the French Competition Authority. There is no filing fee. Failure to notify a reportable transaction is subject to daily penalties and fines.

The majority of notified transactions are cleared within 25 business days of their notification filing. However, certain transactions go through a more in-depth Phase II review which requires an additional 65 business days.

In terms of investment techniques, French corporate law offers various forms of corporate vehicles that can be used for an acquisition or joint venture, including the equivalent of a limited liability company and a company limited by shares.

One of the most commonly used legal entities used by Chinese investors for large transactions is the simplified joint stock company (SAS), as it is a very flexible corporate form: it can be established with a single shareholder and with limited share capital, and the rules governing its functioning are very flexible and can be organised to a large extent freely in the by-laws.

In general, there are no specific requirements that impact a Chinese investor. It is worth noting that French law does not require the participation of a French citizen or entity in French commercial companies, either as shareholders or as directors or officers. Recent regulations requiring the disclosure of the ultimate beneficial owner of a French company, however, does sometimes raise disclosure issues with Chinese investors.

Dispute resolution

On November 28 2007, France and the PRC signed a bilateral investment treaty (BIT) which came into force in France in 2011. It is worth highlighting that French courts are independent and commercial matters are judged in courts composed of professional judges, with an appeal process in front of professional judges. There are also various summary proceedings that can allow an investor to efficiently enforce its rights.

French courts also duly deliver the exequatur allowing foreign judgments and international arbitration awards and deeds received by foreign officers when such judgments and awards have complied with basic principles designed to ensure the fairness of the trial and rights of the defendant.

"China remained the leading Asian investor in France in 2020"

Furthermore, France is party to multiple European and international conventions as well as bilateral treaties (including with China) that provide simplified legal frameworks for the recognition and the enforcement of foreign judgments and judicial cooperation. French judgments and arbitration awards rendered in France (for instance under the ICC Arbitration Rules) are generally enforceable in other jurisdictions.

Tax

Traditionally, Chinese investors would establish holding companies in Luxembourg in order to benefit from lower corporate income tax (CIT) rates. However, these structures are now coming under scrutiny from French tax authorities and there is an increasingly common requirement to have 'substance' in Luxembourg (for instance, actual staff and operations), which is quite costly and burdensome to meet.

Since French CIT rates are being reduced and should match Luxembourg CIT rates by 2022, this type of tax structuring via Luxembourg will no longer be useful.

As of the financial year beginning on or after January 1 2020, a 28% CIT rate applies to the first €500,000 of taxable income, the part in excess of €500,000 being subject to a 31% rate (or 33.33% for MNEs whose turnover exceeds €250 million – Article 219-I of the French Tax Code). This rate will be reduced progressively to 25% by 2022.

Small companies (for example, enterprises at least 75% owned by individuals or by other small enterprises and with a turnover of €7.63 million or less) are taxed at a reduced rate of 15% on the first €38,120 of profits and at the standard CIT rate on any excess (Article 219-I-b of the French Tax Code).

Gross dividends distributed to corporate shareholders outside France are subject to a final withholding tax of 30%, unless there is a tax treaty between France and the foreign country that provides for reduced withholding tax rates (as described below, China and France have signed a treaty providing for a favourable tax treatment). However, no withholding tax is levied on dividends paid by a French company to a qualifying parent company resident in the EEA if certain conditions are met.

Foreign companies established in France enjoy the same government aid and incentives as French companies (such as support for productive investment, R&D, professional training and job creation, among other activities). France also offers some tax and non-tax incentives to French and foreign businesses that are creating new, or expanding existing, businesses in certain French regions, acquiring declining industries or decentralising their activities out of the Paris and Lyon regions.

In addition, taxpayers in France (including foreign investors who have established a business in France) may benefit from the attractive R&D tax credit system. The R&D credit, which takes into account the annual volume of expenditure, amounts to 30% of the expenses related to R&D operations up to a value of €100 million, and 5% for anything above that. Higher rates apply to companies that never benefited from the credit and those that did not benefit from the credit for a five-year period. Certain conditions must be met.

France and China signed a revised double taxation agreement (DTA) on November 26 2013. This agreement reduces the withholding tax rates applicable to dividends, royalties and interests. A Chinese investor will be taxed only 5% on the repatriation of dividends from France if the investor holds 25% of the shares or voting rights in the French company (the withholding tax rate will be at 10% in all other cases). Withholding taxes on royalties and interests paid to investors resident in China are also reduced to 10%.

The DTA also helps to eliminate any double taxation arising from cross-border transactions and to secure the tax position of Chinese investors.

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ASIA-PACIFIC FINTECH SPECIAL FOCUS 2021 CONTENTS

Navigating banking and finance in India from a fintech perspective

Anu Tiwari, Anindita Bhowmik, Ritu Sajnani and Utkarsh Bhatnagar of Cyril Amarchand Mangaldas consider how technology has changed the financial and banking sector in India

Technology coupled with creative business models and increased access to affordable internet is changing our experience of making payments, lending, trading, and investment making it more affordable, convenient, inclusive, and democratic.

Digital payments

Transforming India's payment infrastructure has been on the Reserve Bank of India's (RBI) agenda for a long time and RBI has been resolutely approaching this goal in the past couple of years. The RBI has taken significant regulatory measures recently to regulate payment intermediaries, payment data, tokenisation of cards and e-mandates on recurring payments.

Regulation of payment intermediaries

The RBI released a discussion paper to initiate public consultation on the regulation of intermediaries responsible for collection and settlement of digital payments between the merchants and customers in September 2019.

For the purpose of regulation, the discussion paper differentiated intermediaries that merely provided technological infrastructure for payment without actually handling funds from those that actually collected funds from consumers before transferring them to merchants. The former class of intermediaries are categorised as payment gateways (PGs), whereas, the latter were payment aggregators (PAs).

Bearing in mind the importance of regulation of these intermediaries and the role in handling funds, RBI issued the 'Guidelines on Regulation of PA and PG' dated March 17 2020, followed by a clarification issued by the RBI dated March 31 2021 (PA/PG Guidelines).

The PA/PG Guidelines regulated PAs in its entirety while only providing baseline technology related

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recommendations for PGs. These guidelines were a major overhaul over the previous Intermediaries Circular issued by the RBI on November 24 2009.

The PA/PG Guidelines initially required existing non-bank PAs to apply for authorisation to the RBI before June 30 2021, which timeline considering the ongoing pandemic, was extended to September 30 2021 vide RBI's notification dated May 21 2021. Further, e-commerce marketplaces cannot continue to provide PA services after September 30 2021, and apply for authorisation if the intention is to continue.

Notably the PA/PG Guidelines replace nodal accounts with escrow accounts. Further, it also introduces the concept of 'core amount' in escrow, which would be eligible to earn interest. Escrow accounts would be considered as a 'designated payment system' under section 23A of the Payment and Settlement Systems Act, 2007 (PSSA) such that consumers would have first charge on the balance of escrow accounts in the event of bankruptcy proceedings being initiated.

To ensure interoperability, standardisation, and security of the infrastructure, the PA/PG Guidelines have specified technology related guidelines. Unlike PGs, PAs have to mandatorily ensure compliance with these technology related guidelines.

The March 31 2021 clarification clarified that PA/PG Guidelines are not applicable to 'delivery v payment' transactions, i.e. where delivery of goods/services takes place immediately/simultaneously on the completion of payment by the customer.

The PA/PG Guidelines along with the clarification notification has strengthened the payment architecture of India by filling critical regulatory gaps in terms of regulatory oversight; baseline technology; robust data protection, cybersecurity, and audit framework; anti-money laundering (AML) safeguards; periodic reporting to the RBI; merchant onboarding and merchant monitoring; and dispute resolution.

Further, the interest earned on the 'core amount' in escrow accounts would be a new avenue for PAs to monetise their business.

Data localisation

The RBI had prescribed data localisation requirements with respect to financial data

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"The 2021 Bill allows for certain exceptions for promoting the underlying technology of cryptocurrency"

through its circular dated April 6 2018 (DLC), which directed all payment system operators (PSOs) to ensure that data related to payment systems operated by them is stored only inside India. It includes full end-to-end transaction details which were collected/processed/carried as part of the payment instruction and message. However, a copy of the payments data can be stored in a foreign country if the transaction has a foreign leg to it.

Through FAQs dated June 26 2019, the RBI clarified that if the payment transaction is processed abroad, the related data and all its copies should be deleted from the foreign systems and such data should be brought back to India and stored here exclusively within one business day or 24 hours of the transaction, whichever is earlier.

Vide a letter dated March 26 2021, the RBI has also directed all authorised PSOs to regularly submit a compliance certificate for data localisation requirement to it at half-yearly intervals and more recently, the RBI prohibiting certain card networks from onboarding new customers due to non-compliance with the DLC.

Card data storage and tokenisation

The PA/PG Guidelines have subjected PAs to the same data storage obligations as given for PSOs under the DLC. The PA/PG Guidelines also proscribe merchants and PAs from saving customer card credentials/other related data in their databases.

The March 31 2021 clarification extended the deadline for non-bank PAs until December 31 2021, to enable PAs and participants to put in place workable technological solutions for non-storage of customer card credentials, with suggestions of 'tokenisation' of card numbers as per the RBI's circular on 'Tokenisation – Card transactions' dated January 8 2019 (tokenisation circular).

The March 31 2021 clarification also stipulated that merchants are not allowed to store payment data irrespective of them being payment card industry data security standard (PCI-DSS) compliant, except to the extent required to tracking the transaction in compliance with applicable standards, aimed at protecting financial data of consumers, and enhancing safety and security of payment systems.

E-mandates on recurring online transactions

The RBI has laid down guidelines related to e-mandates through its circular titled 'Processing of e-mandate on cards for recurring transactions' dated August 21 2019, which is applicable for transactions performed using all types of cards – debit, credit and prepaid payment instruments (PPIs), including wallets. It also prohibited levying of charge for availing e-mandate. The circular is effective from September 1 2020.

In January 2020, the scope of the circular was extended beyond cards and wallets to cover UPI transactions as well. The RBI, through notification dated December 4 2020 increased the maximum transaction limit from 2000 rupees (approximately $27.44) to 5000 rupees. Further, processing of recurring transactions (domestic or cross-border) using cards/PPIs/UPI under arrangements or practices not compliant with the e-mandate framework should have been discontinued after March 31 2021.

However, the RBI, vide a circular dated March 31 2021 extended the deadline for compliance by six months to September 30 2021.

Digital lending

A number of digital lending platforms have spawned over the last few years providing instant collateral free loans to people with minimal to no credit history. However, some of these platforms have been found to have dealt fraudulently employed unethical means to recover money and misused personal data.

The RBI recognised the need to rein in these platforms to ensure healthy lending practices and consumer protection. Consequently, the RBI set up a working group on digital lending on January 13 2021, to review digital lending activities and devise an appropriate regulatory approach.

In June 2020, the RBI issued a circular requiring banks and non-banking financial companies (NBFCs) lending through owned or outsourced digital lending platforms to adhere to the Fair Practices Code and guidelines on outsourcing of financial and IT services.

It is imperative that the RBI devises a comprehensive regulatory framework for regulation of digital lending platforms, striking a balance between protecting consumer interests, while allowing digital lending platforms to innovate and offer services to underbanked populations.

Norms and changes around video KYC

Against the backdrop of the ongoing pandemic, the RBI eased the know your customer (KYC) requirements vide its 'May 10 2021 amendment to Master Direction on KYC' (KYC direction).

Video-based customer identification process (V-CIP) is an alternate method of customer identification with facial recognition and customer due diligence by undertaking secure and live audio-visual interaction with the customer to obtain identification information. V-CIP is treated on par with face-to-face CIP.

The KYC Direction allows banks to convert limited Aadhaar OTP based e-KYC authenticated accounts of individuals to full KYC accounts upon V-CIP. The RBI has extended the deadline for completing pending KYC to December 31 2021. It has also permitted V-CIP for customers who are small businesses, proprietorship firms, authorised signatories and beneficial owners of legal entities. Consumers have also been allowed to use DigiLockers to share the documents required for identification.

Neo-banking

There are primarily three different types of models in neo-banking where:

- The licensed entities are branchless and completely digital;
- Existing licensed entity offers digital-only services under a different brand/unit; and
- Consumer facing non-banks (fintech companies) partner with licensed banks and financial institutions to provide a software overlay that enables availing of any banking facility by the consumer.

The last two models of neo-banking can be found in the Indian market.

At present, India does not permit digital only banks. However, the pandemic has necessitated banking services with minimal physical contact and highlighted how digital only banks is the way forward.

Cryptocurrency

The RBI has been sceptical of cryptocurrencies so it published a 2018 circular prohibiting banks from dealing in cryptocurrencies and servicing entities or persons owning or transacting in cryptocurrencies.

The circular was challenged in the case of *Internet and Mobile Association of India v Reserve Bank of India*, wherein the Apex Court, while affirming the RBI's power to take measures in the interest of a robust monetary policy of India.

However, that respite was short-lived as the inter-ministerial committee tasked with examining cryptocurrencies, introduced the Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 (2019 Bill) to ban cryptocurrencies, followed by the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 (2021 Bill).

However, the 2021 Bill allows for certain exceptions for promoting the underlying technology of cryptocurrency, i.e. distributed ledger technology (DLT) and its uses. Like the 2019 Bill, it also aims to create a facilitative framework for issuance of central bank digital currency by RBI.

The Central Economic Intelligence Bureau, an arm of the Finance Ministry, has also recently put forward a proposal to impose 18% GST, saying it could potentially gain 7,200 crore rupees annually on crypto transactions. It is considering to tax buying and selling of cryptocurrencies under the category of supply of goods, while levying tax on crypto exchanges, miners, and wallet service providers for provision of services.

The Ministry of Corporate Affairs also amended Schedule III of the Companies Act, 2013, requiring companies to disclose details of their trade and investments in cryptocurrency.

The government's stance on cryptocurrencies is uncertain and vacillating and long overdue.

Fintech hub at GIFT City

Gujarat International Finance Tech City (GIFT City) is an emerging hub for innovative products, fintech solutions, and start-ups and currently the only notified International Financial Services Centre (IFSC) in India.

IFSCs are established and regulated under the International Financial Services Centres Authority Act, 2019, and supervised by the International Financial Services Centres Authority (IFSC Authority).

The IFSC Authority released a Framework for Regulatory Sandbox on October 19 2020 to facilitate enterprises working in banking and finance to test their innovative products in real time in a controlled environment. It has also released a consultation paper on Proposed International Financial Services Centre Authority (Issuance and Listing of Securities) Regulations, 2021.

It offers a model for financing innovative business models, especially those in the areas of environment, social and governance (ESG), fintech, corporate restructurings including issuance and listing of securities by start-ups, small and medium-sized enterprises (SMEs) and special purpose acquisition company (SPACs), including debt securities on ESG and smart cities.

The IFSC Authority has recently notified the IFSC Authority (Market Infrastructure Institutions) Regulations, 2021 (MII Regulations), with the objective of regulating market infrastructure institutions (MII), such as stock exchanges, clearing corporations and depositories, operating from IFSCs. The IFSC Authority has increased collaborative and cooperation efforts with international and domestic bodies.

Evolving technology

Though technology has drastically changed the financial and banking sector, the regulators have kept with the changing pace to ensure smooth regulation of the sector. Despite the admirable efforts by the regulators, there are certain pressing regulatory issues in digital lending, crowd funding, and cryptocurrencies which require attention.

The Covid-19 pandemic is having far-reaching implications on the banking sector and the pace of adoption of new technologies. It has unprecedentedly highlighted the significance of digitisation of banking and payment activities.

"The RBI has extended the deadline for completing pending KYC to December 31 2021"

ASIA-PACIFIC FINTECH
DIGITAL CURRENCIES

A brief history in digital time

Krishna Ramachandra of Duane Morris & Selvam provides an insight on the rapid proliferation of digital currencies and a snapshot of things to come – beyond cryptocurrencies and blockchain

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The Genesis

This article captures personal thoughts on how the digital ecosystem has caught up on us. For what it is worth, the '2000, 2008, and 2012 debt crises' or 'debt cycles' – depending on whether you take a cynical or macro view of the global financial markets – must be acknowledged for creating the impetus and final onslaught on Wall Street's monopoly on the playbook, and on its narrative – especially on deciding who lives and who ends up picking up the pieces.

This repeated rinse, repeat, cycle finally resulted in the genius use of a distributed ledger technology to create a technological movement that was designed with built-in smart contracting language to effectively function as a new form of currency. It also had a brilliant mathematical formula that, in effect, conjured a monetary and fiscal policy that ensured it remained a robust but fair generative spring that would last, theoretically, until around 2140 and presumably create a new world order in the financial markets.

As a pioneering digital currency, bitcoin had its fair share of arrows on its back. But it has now arisen to be the chosen one – well, at least for now. Perversely, it can be questioned whether bitcoin is now even able to hold down a function as a true currency – it has appreciated exponentially over the last few years so much so that it is no longer meaningfully regarded as a medium of exchange – it is simply and purely a store of value.

It's moniker – Digital Gold – is certainly well earned. However, one must look upon bitcoin as a movement – a philosophy – a narrative that has begun to etch out a permanent pathway for generations beyond the Zs to come. And that pathway is no longer leading to Wall Street. This pathway is metaphorically being digitally created on main street, side streets and mud trails all over the developing virtual worlds.

Digital currency ecosystem

The 'digital currency ecosystem' diagram best illustrates how digital currencies are likely to develop – but perhaps more importantly, how they will come to co-exist in the digital universe.

Much as there is on-going debate about the advent of various types of central bank digital currencies, the steroid-induced programmable digital tokens will certainly be vogue among central banks as they can now start programming to personalised citizenry. This will no doubt be the order of the day as economies around the world start dropping their interdependency on a peg to other G-nation currencies or an irrelevant basket of goods which do not accurately account for the true rate of inflation.

Idiosyncrasies and nomenclature

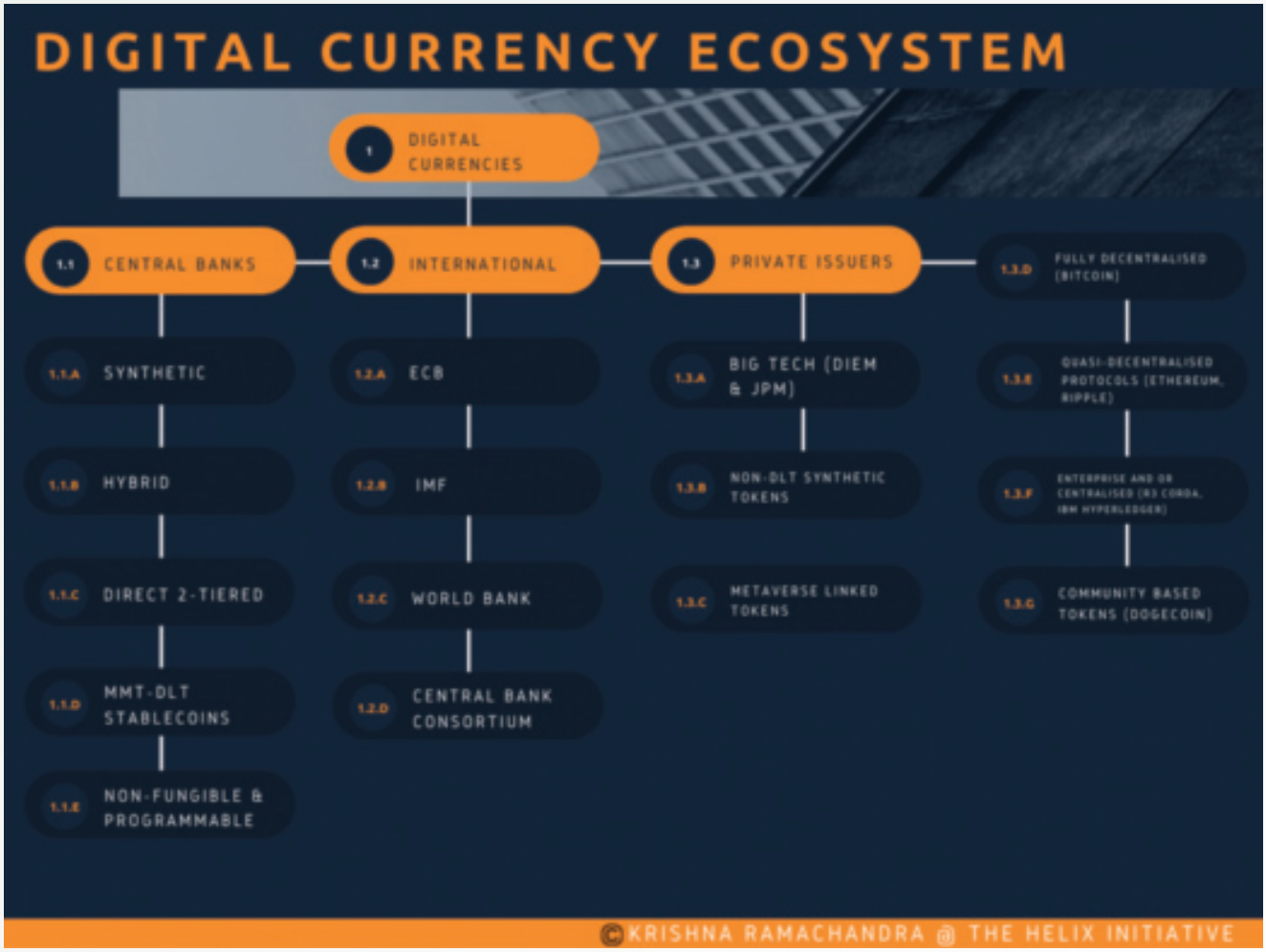
Navigating the digital currency requires one to keep an open mind to accept new ideologies around social behavioural patterns that are promulgated by the creators and early adopters of this technology. Here is where an argument can be made that there will be the emergence of a new economic theory on money, capitalism and scarcity.

Benefits and incentives economic theories will also be redrawn. One established narrative I have observed is what I have termed the 'Doge-Collective'. This refers to a sort of 'me too' fervour that drives members of the community to keep the faith and withhold breaking ranks. This collective creates a certain narrative that disregards age old principles on financial market technicals or 'fundamentals'. Simply put, this is 'power to the people' displayed in its most devastating but perversely elegant manner – to take control of the narrative.

GameStop and Dogecoin are examples that draw out from traditionalists an eerie sense that the entire rule book is going to be re-drafted. Philosophically, the Doge-Collective is the ultimate validation and perhaps, acknowledgement, that one could tribute to the martyrdom of what was the genius of Satoshi and what he, she or they set out to do over 12 years ago – rewriting the narrative by democratising the financial markets.

Coins, alternative coins and tokens

The good news is that there is no holy grail of infrastructure protocols. The altruistic philosophy that underpins this technological revolution commands that everything is shared, and thusly, democratised. Wrong parallels have been drawn with the 'Kodak moment', the 'Betamax runner-up' and the 'MySpace irrelevancy'. That is not how it works with this generation. You see, this generation observes with a religious fervour the fundamental tenet that all things have to be democratised – their data, their finance, their art, their future. There is a brilliance in the simplicity of this narrative. Freedom and choice is as inspiring as it gets. Rival protocols can co-exist. If a better one comes along, you simply hard or soft fork to



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Krishna has advised on over 200 digital technology projects and is widely regarded as a leader in this space. He advises family offices, senior management and boards of companies, typically as an independent senior adviser.

Krishna serves as chairman of The Helix Initiative, a not-for-profit movement dedicated to promoting and empowering thought leadership among the youth. He is especially focused on developing a digital commons protocol and in addressing the growing concerns related to the digital divide.

the platform you choose. No one is left behind.

In sense, you can have your sushi and eat your pancake – and be free to universally swap around as you please. The community works for each other, and collectively they usher along together, bettering each other with higher standards and greater sophistication. Everything is open sourced, for all to share. Ethereum has been a worthy baton holder of what is going to be a multiple relay run – it's not a race.

Above all, it is not a zero-sum game – all can participate and expand the universe to win their own personalised, democratised race in life. The competition is perhaps only on who achieves the credibility to empower the rest. It is this pure and altruistic tenet that I was drawn to several years ago as I consciously parked aside my intellectual arrogance to become open-minded and free of the morass that was the Old World Order, and its unquestioning acceptance of the status quo. Do yourself a favour and watch Ready Player One (and Two when it comes out). That 2018 movie is nostradamic!

Token fungibility

Much has been said, seen and speculated about a class of cryptocurrencies popularly known as non-fungible tokens (NFTs). An important misconception that needs to be clarified is that these NFTs are not merely pieces of $69 million digital art or skins from the gaming world. What the NFTs really represents are the significant shifts and advancements in the sophistication and quality of smart contracts embedded into tokens. This further evidences the maturity of the developer community (a critical factor in assessing the rate of adoption of cryptocurrencies generally).

The 'blockchain evolution' diagram describes the eventual composition of various digital currencies that will interoperate and interact seamlessly across space and time. There are no borders. The markets will be more open – as communities of digital participants globally start recognising the value of their assets (whether represented synthetically or otherwise) but more importantly, governments and the FAANGs (Facebook, Amazon, Apple, Netflix, and Google) will start competing against each other for the citizenry's mind share and revenue – and in the instance of governments – to ensure their equivalent M1, M2 and M3 measurements (to be tracked by a digital equivalent) result in the efficient programmability of central bank issued currencies.

The sophistication in which each programmed digital dollar will hit the wallets of its intended citizens will result in greater citizenry engagement and accordingly, deeper electorate recognition. It will no doubt be a powerful tool that governments must start utilising in an increasingly demanding, and savvy electorate.

So here's the thing – when governments finally go all-in – or rather and perhaps more accurately, when governments realise that the proverbial river has burst its banks – pun completely intended – regulations and legislation will then be crafted, conceptualised, guided and ultimately curated to enable both parties to embrace the efficacies and efficiencies that digital currencies will bring to the fore. Ironically, black markets and tax dodging will be less commonplace.

All parties in theory should win – governments become more efficient and suffer less tax revenue leakage as much as they are required to be more transparent and accountable.

What is next for the banks?

Contrary to popular belief, the onslaught by neo-banks and new digital bank licensees are not going to dislodge the traditional banks – at least not the traditional banks that have taken the initiative to adapt, adopt and acquire the necessary skillsets. For example, JP Morgan and Goldman Sachs lead the charge among the bulge brackets but JP Morgan's playbook is the one to applaud – if not for their opportunistic knack, certainly for their courage to redefine their own industry's status quo.

JP Morgan understood their own internal ecosystem and client base and cleverly developed their very own enterprise grade blockchain platform and their permissioned (private) digital ledger enabled JP Morgan coin to operate as a useful currency ledger within their ecosystem of clientele as well as setting up the framework for a future industry grade payment system.

What is particularly uncanny about JP Morgan's strategy in this digital currency space is their acute understanding of the evolving digital currency ecosystem – as evidenced by their move to offload their demanding (and unprofitable) permissioned blockchain infrastructure protocol (Quorum) to an organisation that would do a better job to enhance and market Quorum widely beyond just as an under-utilised internal JP Morgan synthetic currency ledger.

JP Morgan has also gone on to integrate other traditional divisions of the

bank with their blockchain expertise – their investment and merchant banking divisions seek out synergies and are now able to provide a holistic and truly digital solution to traditional corporate transactions.

For example, JP Morgan's role as an advisor to the recent still-born multi-billion-dollar breakaway European Super League belied their probable strategy to be in a prime position to consequently snag an early adopter advantage. This is because the European Super League would have given them the opportunity to coordinate numerous other token ecosystems given that several of the football clubs involved had already embraced a promising Chiliz coin that is based on a sports and entertainment blockchain fintech solution for sports franchises.

Merchant and investment banking is certainly not dead. JP Morgan has shown the rest of the pack how it is done, and potentially embracing the riches of the digital currency ecosystem at the same time. Traditional banks cannot simply set up a crypto exchange, serve ultra-high-new-worth clientele and assume they have the antidote to non-bank challengers. To the bankers, a siren call to shed the intellectual arrogance and clock in those 10,000 hours.

Lite speed development

The 'blockchain evolution' diagram sets out the chronological evolution of blockchain applications and cryptocurrencies. The adoption by central banks and governments of varying types of digital currencies is a forgone conclusion when one considers the network effect that early adopters are enjoying over the multitude of infrastructure protocols that are beginning to interoperate among each other in quest to reap market share. These early adopters are likely to monopolise the ultimate prize – what I term as the Exponential Trampoline Network Effect (ETNE).

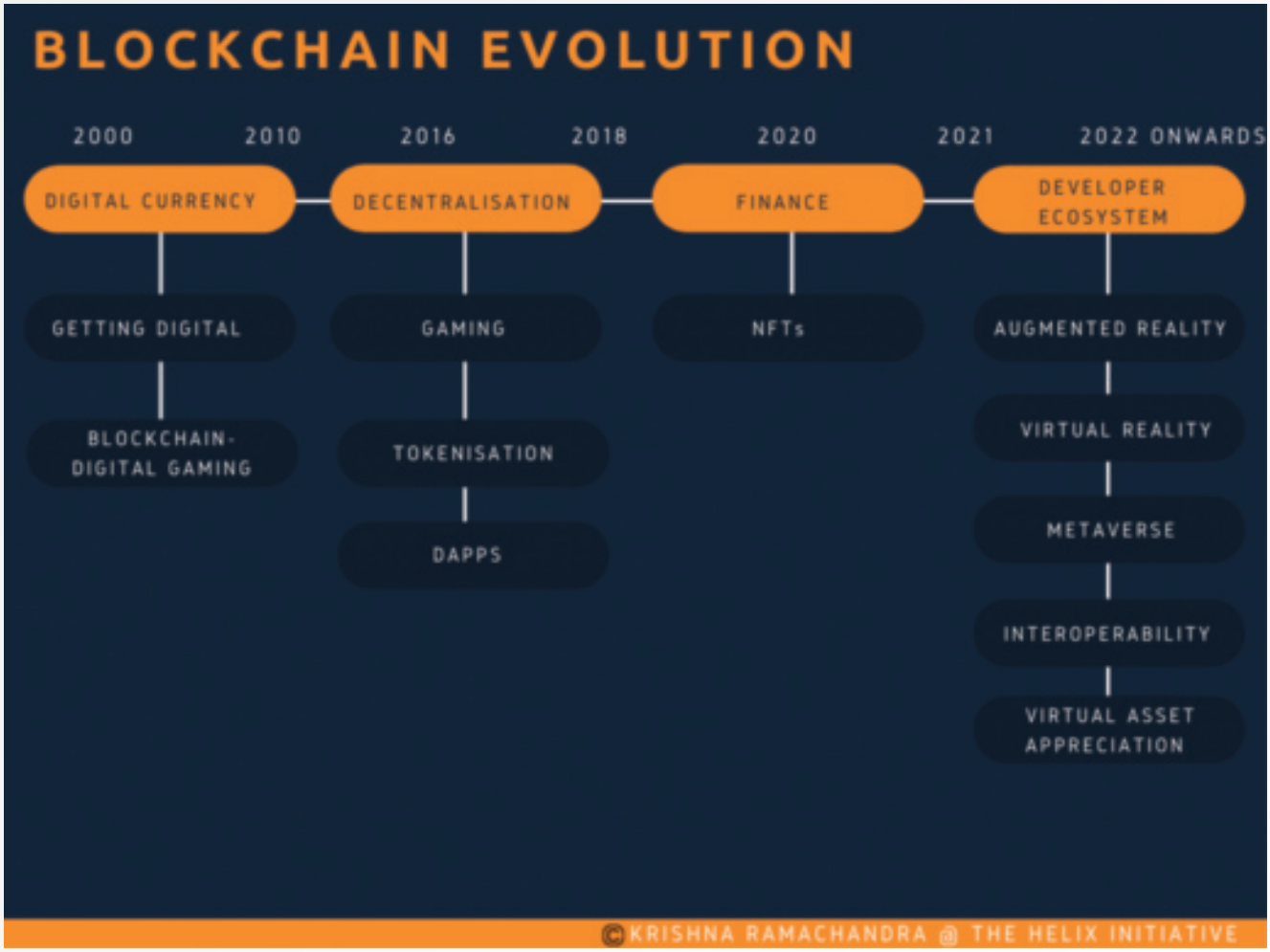
A meshed reality ahead

Digital currencies are going to start occupying the physical and virtual universes as the ecosystem expands beyond the metaverse, which very simply refers to the interoperable gateway dimension between the physical and virtual worlds.

'Traditional' technology companies such as Microsoft have, like JP Morgan, adapted well and staked their claim to a seat at the high table through the launch of the mesh communications platform, effectively converging the realities of the virtual, augmented and mixed universes.

Back on earth, all rational participants would do well to seek out the ETNE in their respective fields or risk being at the wrong end of the digital divide. Watch 'Back from Mars' the movie. Please (or better yet, read the book).

The author would like to thank Leon Yee and Jonathan Vincent Chan Jr for their valuable contributions to the article.



Trends in the non-banking payment industry in China

Jun Wan, Yingyu Xia and Yunzhou Li of Han Kun Law Offices discuss China's payment industry and consider how the government intends to tighten the supervision of this industry

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The People's Bank of China (PBOC) formulated the Measures for the Administration of Payment Services for Non-Financial Institutions in June 2010, which established the regulatory framework for China's non-banking payment institutions (payment institutions).

In a short span of 10 years, China's non-banking payment industry (payment industry) has leapt to the world's top-level along with the rapid development of China's mobile internet and financial technology, and the regulatory level of China's regulatory authorities has also kept pace with the times.

Supervision of the payment industry is tightening, and the government intends to reshape the supervision principles for payment institutions. Based on the recent critical regulatory events in China's payment industry, the regulatory motivations and predictions for future trends of China's payment industry will be analysed.

Important regulatory events in the domestic payment industry

Payment institutions' access to NetsUnion

From April 2016 to June 2018, the PBOC required payment institutions to conduct inter-bank payment services based on the PBOC's inter-bank clearing system or a legally qualified clearing institution.

On August 4 2017, the Department of Payment System of the PBOC released the 'Notice on the transfer of Online Payment Businesses of Non-banking Payment Institutions' from the Direct Connection Mode to the NetsUnion Platform, requiring that from June 30 2018 all payment institutions should process online payment businesses for customer transactions involving bank accounts through a designated network payment settlement platform operated by the NetsUnion Clearing Corporation (NetsUnion).

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The platform now serves as the payment settlement intermediary for any payment institution on one side and the banks of the payers and payees on the other side. According to public data, as of January 2019, all 115 payment institutions that hold online payment licenses have complete access to the NetsUnion platform.

Centralised depository of customer reserve funds

In the early stage of the payment industry in China, payment institutions were allowed to deposit customer reserve funds in the account opened in the name of the payment institutions with the commercial banks.

To strengthen the management of customer reserve funds, the PBOC issued a notice in January 2017, requiring payment institutions to gradually deposit customer reserve funds into the account of the PBOC. Such alteration was finally realised in January 2019 with all customer reserve funds for payment institutions being deposited with the PBOC (except for some specific businesses, e.g. cross-border FX business, cross-border RMB business, payment businesses for fund sales).

In January 2021, the PBOC also issued Measures for the Deposit and Management of Non-banking Payment Institution Customers' Reserve Funds to further clarify the management of the deposit, collection, use, and transfer of the customer reserve funds.

Interconnection of barcode payment

Barcode payment refers to the application of barcode technology (such as barcode, QR code, etc.) by banking financial institutions and payment institutions to identify barcode information through mobile equipment, and

realise the fund transfer between the payor and payee.

Various payment institutions provide users with barcode payment services based on their own technical standards, and there are certain barriers between each other.

In August 2019, the PBOC issued the FinTech Development Plan (2019–2021), providing that supervisory authorities promote the interconnection of barcode payment, research and formulate technical standards for the interconnection of barcode payment, unify barcode payment coding rules, establish technical systems for the interconnection of barcode payment, open up barriers to barcode payment services, and realise the mutual recognition of different APPs and merchant barcode identification.

In the future, if various payment institutions adopt unified barcode standards, it will exert an intensive impact on the current barcode payment market.

Pilot programme of DC/EP

Digital currency/electronic payment (DC/EP), as the legal digital currency issued by the PBOC, has significantly accelerated in terms of its advancement and implementation from 2020 to 2021.

The number of participants and transactions and the exchange amount of the DC/EP pilot test have gradually increased, and the usage scenarios cover various fields such as daily living payment, catering services, transportation, shopping and consumption.

Currently, commercial banks are the DC/EP operating institutions, and the payment institutions may serve as the service institutions. The official launch of DC/EP may reshape the landscape of the payment industry in China.

Rectification of Ant Group's payment business

Ant Group, the fintech giant in China, was summoned and made inquiries by the PRC financial regulatory authorities on the eve of its initial public offering (IPO) in November 2020.

The IPO of Ant Group, which could have been the largest IPO in the history of the global capital market, was forced to suspend.

As to Ant Group's payment business, the authorities put forward a number of rectification requirements, including "returning to the origin of payment, enhancing transaction transparency, prohibiting unfair competition", "correcting unfair competition behaviour in the payment business, providing consumers with more payment method options, disconnecting the improper connection between Alipay and other financial products such as Ant Credit Pay (Huabei) and Ant Cash Now (Jiebei), and correcting irregularities such as nesting credit business in the payment link".

Those rectification requirements also set the standard for other fintech giants in terms of their payment business.

> *"DC/EP has significantly accelerated in terms of its advancement and implementation from 2020 to 2021"*

New regulations reshape regulatory rules

On January 20 2021, the PBOC issued the Regulations on Non-banking Payment Institutions (Draft for Comment) (new regulations). If it is officially implemented in the future, it will completely reshape the logic of license category of the payment industry in China.

According to the current regulations, (effective since 2010), the PBOC divides the payment industry into three categories, namely 'online payment', 'prepaid card issuance and acceptance' and 'bank card acquiring'.

Such standard of classification was primarily based on the technology and medium used in the payment services, and it is difficult to adapt to the actual business model of the fast-developing market.

From the perspective of functionalism, the new regulations categorise the payment business into two types, namely 'operation of accounts with stored-value functions' and 'payment business processing under specific transactions'.

In addition, based on the principle that payment institutions shall not engage in unfair competition, the new regulations establish anti-trust supervisory system consisting of four levels: early warning of market-dominant position, determination of market-dominant position, supervision of violations of fair competition requirements and enforcement of monopolistic behaviour penalties.

International giants enter China's payment service market

On March 21 2018, the PBOC issued Announcement [2018] No. 7, officially clarifying the access conditions and regulatory policies of the investment of China's payment institutions by foreign institutions.

Meanwhile, the PBOC also stated that it will accept the applications for the investment of China's payment institutions by foreign institutions according to procedures and encourage foreign institutions to participate in the development and competition of China's payment service market.

In September 2019, the PBOC approved the application of shareholding change of GoPay (*Guofubao*), a payment institution in China. The international giant PayPal acquired 70% of the shares of GoPay through its subsidiary in China, thus officially entering China's payment service market.

In January 2021, PayPal ultimately holds 100% of the shares of GoPay. The Chinese government is proving to the world its firm determination to open up the payment service market in China by its actions and is taking this opportunity to further expand the opening up of China's financial service market.

Analysis of the motivation of payment industry supervision events

There may be short-term and medium-term motivations behind the above-mentioned regulatory events, which correspondingly reflect the regulatory purposes of the

"The Chinese government is proving to the world its firm determination to open up the payment service market in China"

regulatory authorities in different dimensions. In particular:

- Short-term motivation: to standardise the payment market and reduce the possibility of risk events. For this reason, the regulatory authorities have increased their penalties to increase the cost of non-compliant behaviours of payment institutions and urge payment institutions to operate in compliance. Meanwhile, the regulatory authorities have also considered measures such as 'centralised depository of reserve funds', 'disconnected direct connection', and more pre-regulatory means to the supervisory work.
- Mid-term motivation: to change the current pattern of head players in China's payment industry and prevent systemic risks. The 'barcode payment interconnection', 'Anti-Monopoly Guidelines in the Field of Platform Economy' and the 'Regulations on Non-Banking Payment Institutions (Draft for Comment)' are all aimed at reducing the leadship of certain top payment institutions in the market and preventing some payment institutions from causing 'too big to fail' systemic risks due to mixed operations and other behaviours. In addition, related mobile payment tools may be included in the category of 'financial infrastructure', and the regulatory authorities will strengthen supervision on this.

Regulatory trends of the payment industry in China

In addition to the new regulatory principles established in the new regulations, there may be the following regulatory trends:

Use of personal information and data by payment institutions will be more prudent

Since payment data contains a large amount of personal (financial) information (such as account information, identification information, transaction information, personal identification information, property information, credit information), and considering the unique sensitivity of payment data, we believe that the information and data protection of payment institutions will be one of the critical regulatory areas.

Payment institutions need to be more cautious in developing innovative businesses (such as credit evaluation and risk control modeling) based on personal information and payment data.

Boundary between payment institutions and licensed financial businesses within the group will be clearer

Apart from the main business of payment, if other entities in the group to which the payment institution belongs are engaged in multiple financial businesses, such as the sale of funds, insurance products, bank deposits and credit products, they should first follow the principle of 'financial business must be licensed to operate'. Secondly, payment business and such financial business should establish a clear boundary.

The government will take a more cautious and conservative supervisory attitude towards the overlap between payment services of internet companies and other financial businesses and puts forward the requirements of 'returning to the origin of payment' and 'disconnecting payment tools from improper connection with other financial products'.

Financial consumer protection will be more stringent

Financial consumer protection is also a key regulatory area for the future payment industry. For example, the Implementation Measures for the Protection of Financial Consumer Rights and Interests of the PBOC promulgated in 2020 are directly applicable to payment institutions, which further requires payment institutions to protect the rights and interests of financial consumers, incorporate such protection work into corporate governance and development strategies, establish and improve various related internal control systems, disclose the content to consumers in an authentic, accurate and comprehensive manner, and assume responsibility under regulatory requirements.

In general, we believe that the government will continue to tighten the supervision of the payment industry in the future. On the one hand, payment institutions may realise the centralised depository of all payment funds and real-time monitoring of the entire amount of information; on the other hand, supervision may limit payment institutions to the role of 'pure payment technology provider', all kinds of innovative businesses not directly related to the payment business will be subject to stricter restrictions.

The specific regulatory measures that the regulatory authorities will adopt and the final regulatory effect they hope to achieve will also depend on the future development of the payment industry, and we will continue to focus on it.

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India's data storage conundrum: analysing the RBI's perplexing regulations on storage of card data

Probir Roy Chowdhury and Yajas Setlur of J Sagar Associates discuss why the RBI's policy on data storage could have a devastating impact on India's digital payments industry

www.jsalaw.com

The Reserve Bank of India (RBI) has, with good reason, been lauded for its contributions to India's fintech revolution. The RBI's progressive approach towards regulation and its attitude towards new technologies and business models have been instrumental in shaping the country's fintech industry and in creating a more scalable, secure, and stable financial services landscape.

Yet, despite these achievements, some of the RBI's more recent policy decisions have baffled fintech stakeholders and have been described, candidly of course, as regressive, and short-sighted. Key among these questionable policies are the restrictions sought to be imposed by the regulator on the storage of card credentials by merchants and payment aggregators.

These restrictions, which were supposed to come into effect on July 1 2021, have been deferred to December 31 2021, and will introduce a new source of friction for card-based e-commerce payments which stakeholders fear could force consumers back to cash payments and undermine the tremendous progress achieved in card adoption over the last decade.

Background

The RBI released its guidelines for the regulation of payment aggregators (PAs) and payment gateways (PGs) in March 2020 (PA/PG Guidelines). The PA/PG guidelines regulate the activities of intermediaries, i.e. entities like Razorpay or PayU, that act on behalf of merchants and allow them to collect payments from consumers through the multitude of payment methods that are available in India. The PA/PG Guidelines require PAs – intermediaries that actually collect money on behalf of merchants – to obtain RBI authorisation and to thereafter comply with various operational and technical requirements.

The good...

As expected, the PA/PG Guidelines place considerable emphasis on security, fraud, and risk mitigation. PAs are required to adhere to certain baseline technology conditions and are subject to mandatory system and cyber security audits.

In particular, PAs must comply with the payment card industry data security standard (PCI-DSS) and payment application data security standard (PA-DSS) protocols, which are globally accepted security standards governing the manner in which organisations process, store and transmit credit and debit card data. It may be noted that these protocols are the same standards that banks, and card networks are subject to under Indian law for card data storage. PAs are also subject to direct regulatory scrutiny by the RBI and have quarterly and annual reporting obligations under the PA/PG Guidelines.

The weird...

Interestingly, the PA/PG Guidelines also impose several obligations on merchants in the interest of security and fraud mitigation. The guidelines, for instance, require all merchants to be compliant with advance security standards including the PCI-DSS and PA-DSS protocols, and require PAs to check such compliance on a periodic basis.

And the ugly...

Despite these onerous conditions and obligations, the RBI has severely restricted the ability of PAs and merchants to store and utilise a customer's card credentials. The PA/PG Guidelines explicitly prohibit both PAs and merchants from storing a customer's card data on their databases except for the purpose of 'transaction tracking', a vague phrase which has neither been defined nor elaborated upon. As a result of this prohibition, PAs and merchants will not be permitted to offer customers the ability to expedite future e-commerce transactions by using stored card information.

This ability to store a customer's card data, often referred to in the payments industry as card-on-file (COF), is a feature that is used world-over by multinational e-commerce companies and payment intermediaries to streamline and accelerate card-based payments.

COF significantly reduces the time required by a customer to complete card payments, and also reduces the likelihood of failed or abandoned transactions since it bypasses the manual entry of the 16-digit card number by the customer. The RBI's current policy on card data storage precludes the use of this technology in India and is expected to derail card-based e-commerce payments from January 2022.

Absence of a level playing field

These provisions of the PA/PG Guidelines force PAs and merchants to either ask customers to manually enter their card credentials for every transaction or rely on banks and card networks to store these credentials on the customers' behalf.

From this perspective, it becomes clear that the RBI's policy creates an unlevel playing field for entities in the payments ecosystem. Since the PA/PG Guidelines require PAs and merchants to adhere to very advanced security standards, *viz.* the PCI-DSS and PA-DSS protocols, which are the same standards applicable to banks and card networks, it is unclear why PAs and merchants have been deemed unworthy of storing card credentials. The RBI has not, so far, provided any rationale for this discrimination or any empirical evidence suggesting that data would be safer with banks than in the hands of merchants.

Preclude fraud and risk mitigation measures

Most PAs and large merchants implement proprietary tools and robust systems to identify, analyse and prevent fraud on their platforms and networks. These tools play a significant role in fraud and risk mitigation and allow entities to shield their customers from unauthorised payment transactions and also enable them to swiftly initiate post-incident remedial measures to mitigate harm.

However, these tools often require a customer's card data to carry out the required tracking and analysis and card data is often the starting point for any such risk mitigation exercise. Without this data, these entities have no way of taking proactive steps to protect customers, and must, instead rely entirely on the systems of banks and card networks for this purpose.

No incentive to innovate

In addition to fraud and risk mitigation, card data has also allowed merchants and PAs to develop innovative technologies to provide customers a secure and seamless check-out experience. Since merchants and PAs depend on these payments for sustenance, they have a considerable incentive to innovate. For instance, a smooth payment experience may be a key factor that determines whether a customer chooses to buy groceries from one online retailer instead of another. This incentive drives innovation and investment by merchants and PAs and is responsible for the launch of various features in the payments ecosystem such as single-click checkout and machine learning based retry mechanisms.

In contrast, banks have almost no such incentive to innovate. In the current ecosystem, banks gain very little by creating a smooth and seamless payment experience, and have almost no reason to invest money, time, or resources in creating such systems or tools. It is, in fact, for this very reason that the business of

"Restrictions have been deferred to December 31 2021 and will introduce a new source of friction for card-based e-commerce payments"

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payment aggregation has flourished in India over the last 10 years and given rise to unicorns such as Paytm, BillDesk and Razorpay.

Impact on customer experience

From a customer's perspective, restrictions on a merchant's ability to store card credentials could result in a more painful and tedious e-commerce experience. Merchants and PAs rely heavily on a customer's card data throughout the lifecycle of a transaction to facilitate refunds, cashbacks, discounts, reward points, etc. How the RBI expects merchants and PAs to carry out these processes in the absence of card data remains a mystery.

Notably, any disruption to these critical functions would have a devastating impact on the merchant's brand image but would have no corresponding impact on the bank. A merchant is, at the end of the day, the customer's primary point of contact for any e-commerce transaction. A poor refund experience for a customer would, consequently, impact the merchant most adversely, even if it is caused by the issuing or acquiring bank's failure to share card data. The RBI's proposed framework ignores this fact, and instead places merchants and PAs at the mercy of banks who, as already discussed, have little incentive to improve a customer's e-commerce journey.

"Any plan for the large-scale roll-out of COF tokenisation in India is, at best, ambitious"

Impact on recurring payments

Nowhere is the dissonance of the RBI's policy perhaps more obvious than in the context of recurring payments. In India, thousands of small and large merchants use recurring card transactions as an efficient way of collecting payments from loyal customers. With the growth of subscription-based business models and the relaxation of certain regulatory restrictions, recurring payment have gained a lot of popularity in India in recent years. However, the RBI's restrictions on card data threatens to undo this growth by adding friction to an otherwise smooth process.

Providers of all subscription services, including video and audio streaming services, gym memberships, and internet connections, require a customer's card data to provide such services on a recurring basis. They need this information to trigger transactions and charge a customer's card in a seamless manner. Without COF, these merchants will need to ask for card information from the consumer at every billing cycle, which would defeat the very purpose of recurring payments. Alternatively, these merchants would need to rely on the acquiring or issuing bank to create 'tokens' or similar instruments in place of card information,

"The PA/PG Guidelines place considerable emphasis on security, fraud, and risk mitigation"

the creation of which requires infrastructure that does not yet exist.

Tokenisation: when and how?

Experts in the field agree that these restrictions form a part of the RBI's broader strategy to push the payments industry towards tokenisation. Tokenisation, in the payments context, is a mechanism or feature in which card credentials are replaced with unique surrogate values or 'tokens' for the purpose of conducting transactions.

This need to introduce tokenisation is not, by itself, illogical. COF tokenisation is a well-known card payment feature that is becoming increasingly popular with issuers and merchants around the world due to its security benefits. However, any plan for the large-scale roll-out of COF tokenisation in India is, at best, ambitious. India does not have the regulatory framework or the infrastructure to support such an expansive launch of tokenisation.

The RBI's regulations on tokenisation, which were released in January 2019, for instance, only permit device-based tokenisation. This form of tokenisation depends on a trusted device such as a phone or tablet to store and utilise 'tokens' during payment transactions. However, this framework does not permit cloud-based tokenisation, which is independent of physical devices. Notably, cloud-based tokenisation is an essential requirement for any COF tokenisation feature.

Regulations aside, tokenisation requires the coordination and support of all the players in the payment value chain – acquiring banks, payment processors, card networks, issuing banks and merchants. All these players would need to update their systems and prepare to accept 'tokens' in place of a customer's card data during transactions during all aspects of a transaction's lifecycle, including payment processing, refunds, returns and grievance redressal. Therefore, implementation of COF tokenisation requires a serious overhaul of the entire existing payment infrastructure, not to mention millions of dollars of investment. Not surprisingly, India does not yet have this infrastructure in place, and the country appears several months, if not years, away from COF tokenisation.

The RBI did, in fact, acknowledge the absences of such infrastructure last month when it announced that prohibitions on COF storage would become effective from December 2021 instead of July 2021, as originally provided for in the PA/PG Guidelines. Yet, this six-month abeyance, while certainly welcome, is unlikely to give stakeholders enough time to rebuild their existing systems and make way for a feature as disruptive as tokenisation.

What next?

All things considered, the RBI's policy on data storage could have a devastating impact on India's digital payments industry and could inadvertently undo several years of growth in fintech adoption. With December 31 fast approaching, the payments industry needs to work fast and together. Players need to figure out how to address the regulator's underlying security concerns without parting with the data that they have worked so hard to collect.

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Fintech in Singapore: start-ups, business models and scaling-up

Joshua Tan Heok Ping, Mary-Lisa Chua and Lim Wei Jie of JT Legal discuss the ever-changing playing field of fintech and government initiatives in place to support this industry

www.jtlegal.com.sg

With a small land area and limited natural resources, Singapore's economic focus has always been on its human capital – one of the resources that is easiest to change. As the surrounding region and the rest of the world develops, Singapore has had to find ways to stay increasingly relevant, competitive, and ahead of the curve.

Singapore ranked 2nd in the 2021 Bloomberg Innovation Index and 1st in the IMD World Competitiveness Ranking 2020, and in a Singapore Exchange Limited report last year, Singapore was said to be the 'ASEAN capital of fintech', with more than 750 financial technology (fintech) companies based in Singapore.

However, this is no miracle – the Singapore government has put various measures in place to grow and groom talent in Singapore. In relation to fintech specifically, some government initiatives include:

- Fintech innovation lab;
- Financial sector technology and innovation proof of concept scheme; and
- Fintech regulatory sandbox.

Other than implementing initiatives to encourage the use and development of fintech by start-ups in Singapore, the government has also shown interest in developing fintech for institutional use.

In 2016, the Monetary Authority of Singapore (MAS) embarked upon a five-year collaborative project with industry players to explore and understand the benefits of blockchain and distributed ledger technology for clearing and settlement of payments and securities through practical experimentation. Industry collaborators ranged from established financial institutions to technology companies like R3, a distributed ledger technology company, and IBM.

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While state interest is not strictly necessary for the development of technology, the government's fairly active role in exploring and encouraging the implementation of fintech in Singapore has helped the legislative and regulatory framework in Singapore stay updated with innovation.

This groundwork laid by the government proffers added clarity and certainty, so that businesses may more confidently deploy and/or develop fintech. The various regulations, such as the necessity to be licensed for certain activities, also provides businesses who are keen to adopt fintech solutions with the peace of mind that there is government oversight, and fintech providers cannot abuse the technology to exploit the less well-informed.

With Singapore ranking 2nd in the World Digital Competitiveness Ranking, and 40% of all fintech companies in Southeast Asia calling Singapore home, it is clear that Singapore has established itself as one of the leading fintech hubs in the region.

Despite this, Singapore's technology adoption was rated 1.96 out of a possible 3 in Cisco's 2019 Digital Readiness Index – while there may be many fintech companies in Singapore, many companies may not yet be aware of how to leverage fintech to work smarter.

Types of fintech and notable companies

As the fintech industry matures, the types of technology encompassed by the term have grown to include:

- Payment services;
- Peer-to-peer lending; and
- Data collection, management and storage.

Some notable companies in Singapore's fintech space include 'decacorn' Grab, Zilliqa Research and Validus.

Payment services

In 2021, MC Payment Limited became the first digital payment services company to be

"Singapore has had to find ways to stay increasingly relevant, competitive, and ahead of the curve"

listed in Singapore. It is among the ten companies with a major payment institution licence to conduct merchant acquisition services.

Digital payments became an oft-mentioned topic in the year 2020 for several reasons. One of the more practical reasons was that it provided a mode of contactless payment to reduce person-to-person contact, a relevant concern amid the outbreak of the extremely infectious Covid-19.

With businesses increasing their online presence, especially in the wake of Covid-19, payment services allow businesses to generate revenue from a larger pool of consumers – where cross-border money transfer is allowed, businesses can even expand through their online business, without incurring the costs of traditional geographic expansion through brick and mortar locations.

Another reason for the buzz was that at the start of 2020, the Payment Services Act 2019 (No. 2 of 2019) took effect, and many companies were consequently taking steps to comply with the updated legislation and to submit licence applications as prior to the Payment Services Act 2019, there was no consolidated act governing payment services on a whole.

New activities such as digital payment token (DPT) services and merchant acquisition services that were not regulated under previous legislation related to payment services were brought under the purview of the Payment Services Act.

Entities hoping to be granted a licence should, among other things, ensure that they have adequate anti-money laundering and know-your-client procedures in place; payment services that facilitate the movement of money, especially across borders, may be exploited for illicit purposes such as money laundering or the financing of terrorism. In particular, the use of virtual assets like cryptocurrency favours anonymity and are even more liable to being abused.

In early 2021, Singapore amended the Payment Services Act 2019 to introduce enhanced anti-money laundering measures for companies offering DPT services. The requirements which are to be complied with are extensively set out in MAS Notices including MAS Notice PSN01 (for payment services other than DPT services) and MAS Notice PSN02 (for DPT services). MAS has also issued accompanying guidelines to these notices.

Moreover, licence-hopefuls should also note that their corporate structure may come under scrutiny. Where the licence applicant is a Singapore-incorporated company or a Singapore branch of a foreign-incorporated company, there should be (a) at least one executive director who is a Singapore citizen or permanent resident; or (b) at least one executive director who is a Singapore Employment Pass holder and at least one other director who is a Singapore citizen or permanent resident.

Companies who wish to integrate payment services with their current business processes should ensure that they use the products or services of licensed entities, as such licensed entities' internal procedures would have passed muster. Other than anti-money laundering procedures, a licensed entity should also, as far as possible implement the measures set out in MAS' technology risk management guidelines and requirements from time to time. For example, a recovery time objective of not more than four hours must be established for each critical system.

Peer-to-peer lending

Other than traditional fundraising rounds, companies now can utilise crowdfunding to raise money. Some platforms even allow for securities-based crowdfunding. This is made easier with technology facilitating the flow of money, including peer-to-peer lending. With peer-to-peer lending, companies may have greater access to funds at competitive interest rates, and may be more willing to take on debt on their balance sheets.

Start-ups who make use of such lending-based crowdfunding platforms should ensure that their offers made to investors do not trigger prospectus requirements. The triggering of prospectus requirements may cause undue disruption in a start-up's operations – unnecessary attention from regulatory authorities may be received where a company unknowingly makes an offering without a prospectus despite being required to do so under legislation.

Further, there may be operational issues arising from a miscalculation of cashflow; to avoid regulation at the last minute, companies may have to adjust the amount raised and the number of investors involved so that the company need not issue a prospectus.

Prospectus exemptions include, subject to additional conditions being met:

- The small offer exemption, where offerors may make personal offers, up to an aggregate of SG$5 million (approximately US$3.7 million) in a rolling 12-month period;
- The private placement exemption, where a company may make an offer to no more than 50 persons in a rolling 12-month period; and
- Offers to institutional or accredited investors.

Fintech start-ups wishing to offer such peer-to-peer crowdfunding solutions should also ensure that they obtain the relevant licence(s). As a peer-to-peer lending platform operator is facilitating the offer of debentures, it may be considered to be carrying on the business of "dealing in capital market products", a regulated activity under the Securities and Futures Act (Cap 289, 2006 Rev Ed) of Singapore.

"In 2021, MC Payment Limited became the first digital payment services company to be listed in Singapore"

As such, a peer-to-peer lending platform operator may have to apply for a capital markets services licence. Where the platform also provides parties with financial advice, it may also have to obtain a financial advisor's licence or a capital markets licence for the provision advising on corporate finance. Under MAS Circular No. CMI 27/2018, MAS has also imposed certain disclosure obligations on licensed platform operators including:

- The interest rate per annum;
- The interest rate per annum net of all fees and charges that the investors will receive;
- For loans disbursed in each of the past three calendar years:
- The lowest and highest expected rates of returns, net of fees and charges to investors; and
- The weighted average expected rate of returns, net of fees and charges to investors;
- Non-performing loan rates.

Obtaining a licence from Singapore's regulatory authorities, while time-consuming, may also be a good investment by a fintech start-up. Singapore's regulatory authorities are renowned for their stringent oversight, and a Singapore licence will be a testament to the quality of a company and its products and/or services.

To this end, companies who wish to raise money through such platforms may also want to ensure that the platform is licensed and trustworthy. In the event that the platform does not safeguard investors' interests enough, a company's name may be permanently tarnished by such bad publicity.

Data collection, management and storage

Insofar as personal data is collected, used or disclosed in Singapore, the Personal Data Protection Act (No. 26 of 2012) (PDPA) will apply.

The PDPA will apply even if a company does not have physical presence in Singapore. As such, fintech companies who collect personal data from individuals in Singapore will have to comply with the PDPA. Under the PDPA, 'personal data' is defined as "data, whether true or not, about an individual who can be identified (a) from that data; or (b) from that data and other information to which the organisation has or is likely to have access".

Such personal data may include data collected and used for biometric verification; as increasingly sensitive processes are being moved online, fintech companies may use biometrics to control access to confidential or sensitive information. For example, DBS recently introduced facial recognition as a means of authenticating and verifying information for small and medium-sized enterprises (SMEs)setting up a corporate online account with DBS.

Another type of fintech which may involve personal data is capitalisation table and employee share option plan management services. Such a data management service can help companies to keep track of the shareholding in their company more easily and with greater accuracy, especially as the company goes through multiple investment rounds and employee share options are issued and exercised from time to time. This may make it easier to account to investors, and provides convenient visibility of a company's shareholding. For start-up founders, this may also help them to best strategise how to maintain specific proportions of shareholding so that control of the company does not change easily.

For companies collecting the personal data of investors and employees, their PDPA obligations will not change if they had collected such personal data prior to the deployment of the management technology.

While it is clear that fintech is still evolving, the changes it has brought in its years of existence have already altered how we live and how companies operate. To incentivise and support fintech and its adoption in Singapore, Singapore's government has introduced several initiatives, including the SG$125 million Covid-19 support package for fintech companies, the SG$150 million Startup SG Founder scheme for innovative startups and the Technology Adoption Programme, aimed at supporting businesses in adopting new technologies that have been identified and translated into Ready-to-Go solutions to retain their business competitiveness.

"The only constant in life is change" – Heraclitus.

Settling into a familiar way of operations is easy, but for fintech companies and companies who are able to utilise fintech, where the playing field is ever-changing, it is paramount to be open to change lest they stagnate, for stagnation is death.

Emergence and growth of fintech start-ups in India

L Badri Narayanan and Gaurav Dayal of Lakshmikumaran & Sridharan consider key factors that will play a major role in the scaling up of start-ups in India to help transform the landscape of the fintech sector

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The Financial Stability Board (FSB) defines 'fintech' as "technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services".

The 2015–2020 period has seen phenomenal growth in new start-ups across India in fintech, especially in digital payments, lending and wealth segments. According to the 'MEDICI India FinTech Report 2020', India had the second highest number of new fintech start-ups in the last three years after the US (data for China not considered).

At present there are more than 2,000 fintech companies in India. The Boston Consulting Group in its recent report has stated that there will be a $100 billion value creation opportunity and that India is strongly poised to realise a fintech sector valuation of $150–160 billion by 2025.

This article highlights the key enablers and role of the government in emergence and growth of fintech start-ups, key segments for fintechs and the roadmap for the scaling up of fintech start-ups.

Emergence of fintech start-ups

The emergence and subsequent growth of fintech startups in India can be contributed to various factors. Some of the key drivers have been discussed below.

Key drivers for fintechs in India

Various factors act as key enablers resulting in the success of fintech start-ups in India, including:

- Availability of capital and a vibrant investment ecosystem;
- Favourable demographic in India (more than 65% below the age of 35 years) having an appetite for innovative technology;

"India is strongly poised to realise a fintech sector valuation of $150–160 billion by 2025"

- Low penetration of financial services for a majority of population (unbanked, rural regions, as well as small and medium-sized enterprises (SMEs));
- Government initiatives and regulatory forbearance to fintech;
- Increased mobile and internet access;
- Reduced infrastructure and transaction cost through usage of cloud-based services and IndiaStack; and
- Advancement in technology.

A few of these key drivers are discussed below.

Maturing investment ecosystem

One of the most difficult tasks for any entrepreneur is to raise enough funding. There are many factors which affect the dynamics of investor behaviour such as diverse and innovative products, business model, the stage of development of a product, asset position, future earning potential and domain knowledge. As mentioned above, investments in fintech start-ups have risen dramatically in recent years. Ease of capital has helped fintechs to drive innovation as well as their business model.

In addition to private equity (PE) and venture capital (VC) investments, Indian fintechs have also benefitted from the support received from various sector focused incubators, accelerators and tech-hubs.

Most of the incubators and accelerators are either university-led, public sector-led, equity-led or financial institution-led. These incubators, accelerators and hubs perform several functions, and when combined, have had a synergetic effect on startups undergoing acceleration, and a positive impact on the fintech industry's overall growth.

Technology and digital infrastructure

Technology has been a fundamental enabler in the field of fintech. Innovations like blockchain, artificial intelligence, machine learning, biometric, robotic process automation, instant payments, internet of things, cloud computing has led to major transformations of the financial service industry.

The backbone of the infrastructure for fintech in India has been strengthened with the host of options available to market participants such as BBPS, Bharat QR, India Stack and UPI. According to BCG, India's public digital infrastructure – IndiaStack, has generated strong tailwinds for the fintechs in India. The open-API infrastructure has been leveraged heavily by fintechs to address diverse use-cases and has helped fintechs in significantly reducing costs of acquisition and servicing.

According to MEDICI, the Account Aggregation framework (being an interoperable and technology agnostic framework) is envisioned to bring in a new kind of digital data model wherein account aggregators (regulated by the special NBFC-AA license) will act as data access fiduciaries between users/entities who are the primary owners of data and banks/financial institutions that maintain and manage it. At present, the Reserve Bank of India (RBI) has issued four operating NBFC-AA licenses and two in-principle NBFC-AA licenses.

Policy and regulatory initiatives for fintech industry in India

Given the fintech sector's competitive existence and overlap with other industries, effective policy and regulation are critical for the sector's growth and stability. India witnessed a phenomenal growth in cashless transactions with the introduction of demonetisation.

Some of the recent Indian government programmes towards creating a favourable business climate for fintech companies are Unified Payments Interface (UPI), Jan Dhan Yojna, Startup India, Digital India Programme, Recognition of P2P lenders such as non-banking financial companies (NBFCs) and National Common Mobility Card (NCMC).

The RBI, to establish an effective structure for a Regulatory Sandbox (RS) for fintech products, announced its detailed framework on RS in 2019 including provisions for entry and exit of startups, duration and indicative list of innovative products, additional services available and technology which could be considered for testing under RS.

The insurance regulator (IRDA) introduced the IRDAI Regulatory Sandbox in 2019 to strike a balance between the insurance sector's orderly growth and the security of policyholder interests, while also promoting innovation in the insurtech space. Similarly, the securities regulator (SEBI) in 2020 has also released a framework for RS for entities registered with it to experiment fintech solutions.

In general, Indian regulatory authorities (including RBI, SEBI and IRDA) have adopted a consultative approach towards the fintech sector and have provided a broader

S. No	Segment	Key sub-segment/business models	Key players (illustrative)
1.	Digital payments (Electronic payment solutions covering both remittances and enterprise/ merchant payments)	▪ Payment gateways and payment Aggregators ▪ Bill payments and money transfers ▪ Payment infrastructure - POS/QR codes ▪ Digital wallets ▪ P2P Payments	Paytm, PhonePe, BharatPe, Razorpay, Oxigen, Juspay, PayU, MobiKwik, Instamojo, Pine Labs, BillDesk, CCAvenue, Ezetap
2.	Alternative lending	▪ Digital consumer lending ▪ SME financing/invoice financing ▪ P2P lending ▪ Aggregators ▪ Credit scoring platforms	LazyPay, Zest, Lendingkart, InCred, CreditMate, EarlySalary
3.	Wealthtech	▪ Personal finance management ▪ Investment platforms ▪ Robo-advisor ▪ Digital discount brokers	Bankbazaar, Upstox, Zerodha, Scripbox, Paisabazaar, Groww
4.	Insurtech	▪ Aggregators/policy management ▪ Software/white label/infrastructure APIs ▪ Online Insurance ▪ Claims management ▪ IoT/telematics ▪ Bite-size insurance/ microinsurance	Policybazaar, Acko, Digit, Coverfox, Arvi, Toffee Insurance, Easypolicy, BeatO
5.	Neobanking	▪ Retail neobanks ▪ SME neobanks	Niyo, Jupiter, Finin, Neo, Kaleidofin
6.	Enablingtech and Regtech	▪ B2B SaaS (including customer acquisition and service) ▪ E-KYC, AML, fraud and compliance ▪ Account aggregation ▪ Data capture and integration ▪ Risk management	CustomerXPs, SayPay, KhataBook, ClearTax, EaseMyGST

framework and sandbox environment to encourage responsible innovation. Fintech start-ups have also benefitted from the government's pro start-up policies and accommodative regulatory conditions.

Fintech: key segments and business models

Initially, fintechs were mostly concentrated in payments and lending, however, growth of the fintech ecosystem has encouraged diversification of new fintech platforms in different segments. Set out below are the key segments and a few business models within such segments that have been adopted by the fintechs in India (see table above).

Roadmap for scaling up fintech start-ups

In order to ensure scaling up of fintech start-ups, some of the key challenges will need to be addressed.

Challenges for fintech sector

Like with any sector, the Indian fintech sector also faces some challenges that could impact its growth. Some challenges are structural in nature which are likely to have an impact across most segments of fintech.

Absence of fintech specific regulations and regulator

RBI and SEBI are yet to come out with comprehensive and separate guidelines for the fintech sector and it continues to be governed by banking and securities regulations. Increased regulation could hamper innovation – which is key attribute

of fintech – and also drive up operational costs. However, regulatory coherence will support growth of the fintech sector in the long run and help in gaining customer trust – a key factor in attracting more capital. Like any other sector, as fintech sector matures and the start-ups scale-up, they are more likely to be subject to greater scrutiny from regulators.

The key challenge for the regulator is to create an ecosystem fostering innovation, while balancing issues relating to customer protection, data security and privacy. The accelerated rate of innovations in the fintech sector has at times led the regulators to play catch-up and have knee jerk responses to certain market activities, for instance its stand on cryptocurrency, payment regulations and capping of market share by the National Payments Corporation of India (NPCI).

Systemic risk

According to RBSA Advisors, with the huge expansion of fintechs and the proliferation in underlying delinquencies due to the nature of the credit flow, it is imperative to have prudential regulation controlling and limiting the system wide risk proliferation. Traditional banks give advances sourced from deposits, whereas fintech start-ups lend from debt funds/equity investments. Thus, the risk can permeate to various categories of people including investors, consumers and enablers.

Data security and privacy risk

The fintech sector has benefited the most from unrestricted data flow. The fintech industry's biggest issue is the industry's hidden cybersecurity risks which include data breaches, third-party security threats, ransomware, application security threats, cloud-based security threats, and digital identity risks.

To combat the cyber threat and prevent hackers from gaining access to sensitive data, a balanced approach to innovation is needed to support the fintech industry's growth. A rapid digital transition has forced unprepared governments around the world to step up legislative efforts to protect citizens' data and rights.

To safeguard the interest of the users, as per Srikrishna committee's recommendation, the Personal Data Protection Bill 2019 was

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"Effective policy and regulation are critical for the sector's growth and stability"

"The 2015–2020 period has seen phenomenal growth in new start-ups across India in fintech"

introduced in the Lok Sabha to make data localisation mandatory for all sensitive personal data (PDPB). Fintech startups' business models are highly reliant on outsourcing technical support and cloud services to low-cost, competitive service providers.

Due to data localisation standards proposed in PDPB, start-ups will be unable to choose the most cost-effective cloud service providers from a global supply pool. Data localisation would also require them to participate in product re-engineering in order to comply with complex regulations which will increase technological and operating costs.

Limited early stage and PoC funding

Despite the growth in overall funding of fintech start-ups, proof of concept (PoC) and early-stage funds are still limited according to Yes Bank 'India Fintech Opportunities Review' (IFOR). As part of its study, IFOR has highlighted that:

- 71% of pre-revenue and 81% idea-stage fintech startups noted 'severe difficulty' in raising funds; and
- There is an even bigger challenge in PoC funding – only 11% report that they received funding and 19% stated that their industry partners paid for the PoCs.

KPMG in its 2020 report on fintech has also highlighted that fintech investors adjusted their strategies in H2'20, moving away from early stage companies and towards later stage companies; investors also focused more on profitability. Foreign investment restrictions on neighbouring countries (including China) introduced in April 2020 have also added uncertainty around startup funding.

Scaling up of fintech start-ups: Outlook for the next few years

Due to Covid-19 and the economic slowdown it resulted in, the fintech segments have seen a significant dip in terms of the number of start-ups being funded during the initial months of the pandemic. However, the year-end witnessed these numbers starting to rise and a positive traction was witnessed across all fintech segments.

With successful fintechs as well as financial institutions looking at adding new products/segments, the next few years are likely to see consolidation in the sector and an uptick in M&A activity wherein:

- Financial institutions will look acquire or invest in fintechs in corresponding segments for their technology and customer access;
- Larger and more successful fintechs will acquire smaller players across segments to bring width to their business, for access to larger customer base and higher customer engagement.

Moreover, few of the larger fintechs (such as Paytm and PhonePe) as well as large tech companies including Google, Apple, Facebook, Amazon, Microsoft (GAFAMs) and large Indian conglomerates (Reliance and Tata) are looking at an ecosystem orchestrator ('super app') approach that has been observed in the success of Chinese fintechs (Ant Financial and Ping An). This will also add to the M&A activity in the sector.

International expansion is another route that the fintech start-ups will look to adopt to pursue scale. This holds true for international start-ups foraying into India and for Indian startups going overseas. Indian start-ups will need to carefully identify pilot geographies/markets to test success before scaling up and foraying into other markets. One approach that may be adopted for choosing the pilot market is regulatory and cultural contiguity as well as business model portability.

The continuously increasing collaboration between traditional financial institutions and fintech start-ups in the form of supplementary offerings (integration and co-creation), partnerships/distributions, acquisitions, incubation and investment will remain to be one of the key drivers of India's fintech growth as well.

While fintechs bring technological innovation and agile execution capabilities to the fore, financial institutions bring the benefit of scale and customer reach to the table. Moreover, fintech start-ups can also learn and adopt best practices around operational excellence as well as risk, compliance and internal controls that most of the financial institutions in India have successfully put in place.

The above factors will play a major role in the scaling up of start-ups in India and would help transform the landscape of the fin tech sector.

The authors would like to thank Sumedha Kalra (Associate) and Pragya Pandey (Associate) for their assistance.

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Lakshmikumaran & Sridharan is a leading full-service Indian law firm specializing in areas such as corporate & commercial laws, dispute resolution, taxation and intellectual property. The firm is able to keep a finger on the pulse of litigation and commercial law matters throughout the country through offices in 14 locations in India. The firm's driving principles are integrity, knowledge, innovation, and collaboration.

The firm has handled more than 30,000 litigation cases before various forums both in India and abroad including 2,000 cases before the Supreme Court of India. Over the last 36 years, the firm has worked with over 15,500 clients which range from start-ups, small & medium enterprises, to large Indian corporates and multinational companies.

The professionals have experience of working in both traditional sectors such as commodities, automobile, manufacturing, healthcare, IT/ITeS, FMCG, hospitality, real estate, petrochemicals and modern sectors such as e-commerce, fintech, big data, renewables, gaming and sports. The firm is proud to combine knowledge of the law with industry experience to design legal solutions for their clients to implement.

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Transitioning into a new crowdfunding hub

Despite – or perhaps even because of – the Covid-19 pandemic, the fintech sector in Cyprus exhibited strong progress in 2020. During the year, and throughout the beginning of 2021, the regtech and cryptocurrency clusters have also grown and the Cypriot government has played an important role in enabling the evolution. It aims to secure Cyprus's place as a leading international financial centre and as a result, it has promoted a properly regulated fintech sector, as well as research and innovation.

Cyprus has established the Deputy Ministry of Research Innovation and Digital Policy to promote, guide and develop the digital transformation of Cyprus and to facilitate the start-up of innovative businesses. There is also a generous EU and state financial support package in place to fund specific projects in the next few years. However, funding gaps remain, and with a historic lack of a venture capital or business angel culture in Cyprus (or Europe), it is far from surprising, given the rapid advance of technology, that a number of 'crowdfunding' platforms have emerged to fill the void.

While in many respects this is a welcome development, it has raised legitimate concerns that some aspects of the operations of such platforms fall outside existing investment and banking regulations and may require specific regulation to ensure transparency and the protection of investors.

Cyprus legislative initiatives

CySEC crowdfunding directive

As a clear example of the effort to attract fintech companies whilst simultaneously promoting itself as a bona fide, well-regulated destination for investors, Cyprus chose to take action to regulate the crowdfunding sector in advance of any legislation on the part of the EU. In January 2020, following stakeholder consultations, the Cyprus Securities and Exchange Commission (CySEC) published the 'Directive DI87 – 10 on the provisions of crowdfunding services in respect of transferable securities' (the crowdfunding directive).

CySEC's crowdfunding directive relates solely to investment-based crowdfunding through transferable securities and excludes loan-based, reward-based and donation-based crowdfunding. The crowdfunding directive comprises a set of secondary rules for investment-based crowdfunding under the law. It is complementary to MiFID II's obligations, including but not limited to: conduct of business rules; management of conflict of interests; holding clients' money and financial instruments and product governance. Under the crowdfunding directive, if offering cross-border transferable securities via investment-based crowdfunding, crowdfunding service providers and their platforms are subject to prospectus thresholds governing the marketing, sale and distribution of securities across the EU.

The crowdfunding directive also imposes additional provisions aimed at ensuring investor protection on Cyprus investment firms (CIFs) acting as crowdfunding service providers. Briefly, the most significant of these include:

Measures to prevent conflicts of interest

CIFs are subject to neutral intermediation through licensing and activities restrictions. CIFs are not allowed to receive order routing benefits in respect of crowdfunding projects in general. CIFs are not allowed to acquire (equity or debt as the case may be) participation in crowdfunding projects on a platform or allow 'involved persons' to act as project owners.

Measures to implement due diligence procedures

Additional customer and financial due diligence in respect of both the crowdfunding project (including credit risk) as well as the project owner, must be implemented before a project can be listed on a platform. Identity verification and anti-money laundering checks must be performed on both the end-investor and project owner.

Measures to ensure transparency

Project owners must produce a standardised pre-contractual document (under the responsibility of the project owner), including the natural persons effectively conducting the project owner's business. This must be detailed in a key investment information sheet (KIIS). Certain procedures are in place to ensure that the content of KIIS is up to date and for rectifying errors or omissions. CIFs acting as crowdfunding service providers must ensure that the content of KIIS is clear, complete and accurate before accepting a project on their platform. Marketing communications must be clear, accurate and not misleading, and consistent with the content of marketing communications and the KIIS.

Measures to safeguard clients' funds and financial instruments

All monies raised via the crowdfunding platform must be transferred by the CIF to the project owner only after the successful closing of the relevant offer. Financial instruments (i.e. transferable securities (TS)) are subject to safekeeping, and must be divided into custodial and non-custodial transferable securities. CIFs acting as crowdfunding service providers may only release the funds to the project owner where the TS have been physically delivered or where sufficient evidence is provided by the project owner to the CIF that the ownership of the TSs has been transferred to the respective investors, in line with their contributions.

Measures to promote investor exit opportunities

CIFs which are crowdfunding service providers may operate a bulletin board through which crowdfunding clients of the CIF may advertise their interest to buy or sell (as the case may be) transferable securities that had been made available through the CIF's platform. Such bulletin boards are to operate as information exchanges only, they are not to be used as a trading venue.

CySEC's crowdfunding directive was introduced whilst the European Commission's proposal for an EU Bespoke Crowdfunding Framework (the framework) was still subject to an ongoing legislative process. It was viewed as a bridging step necessary for the protection of potential investors. Its contents took into consideration the content of the proposed framework, without prejudice to the overall investor protection offered by the MiFID II

regime. The intention was to provide interim protection in a manner designed to facilitate a smooth legislative transition at the appropriate time.

EU legislative initiatives: Regulation 2020/1503

On October 5 2020, with a view to facilitating cross-border corporate financing, the European Parliament approved Regulation 2020/1503 'on European collective financing providers for business' (Regulation 2020/1503). Regulation 2020/1503 incorporates the framework. It enters into force on November 10 2021.

The new EU framework is a key element in the EU's strategy for a capital markets union. It aims to eliminate the fragmentation of the legal framework for crowdfunding and to promote cross-border corporate financing, while improving investors' protection and the efficiency of the single capital market. In future, crowdfunding platforms operating in more than one member state will be able to organise their activities according to uniform rules – they will no longer have to comply with national rules separately in each EU member state.

In contrast to the crowdfunding directive, the scope of Regulation 2020/1503 captures both lending-based crowdfunding (facilitation of lending not the provision of loans) and investment-based crowdfunding, with a ceiling of €5 million (approximately $6.1 million). As with the CySEC crowdfunding directive, reward and donation-based crowdfunding is excluded.

Key provisions of Regulation 2020/1503

Crowdfunding loans

The regulation introduces the concept of authorised crowdfunding platforms and makes it clear that such platforms are only permitted to facilitate the conclusion of loan agreements between investors and project owners. At no time may the platform act as a creditor to the project owner.

Accordingly, as is currently a common occurrence in Europe, if the platform wishes to issue a loan to the project owner and, after issuing it, offers the claims related to such a loan to investors it cannot be authorised as a crowdfunding platform under Regulation 2020/1503. If offering such a service a platform might meet the characteristics of a credit institution or investment brokerage company, in which case it would require a separate authorisation before it could operate. The same would apply if, through the platform, third parties offered investors to purchase the loans they had originally granted by transferring them.

Crowdfunding as a payment service

The framework clarifies one of the key issues that has so far been regulated and interpreted differently across the member states. Namely, whether the acceptance of funds from investors and the creation of virtual accounts are subject to the regulation of payment services. Regulation 2020/1503 states that the authorisation to provide collective financing services is not comparable to the authorisation to provide payment services.

In the event that a platform provides payment services, such as offering to set up a virtual account, then the platform must be licensed as a payment institution or cooperate with a third-party platform provider who holds such a license already. If the platform provider decides to cooperate with a third-party payment institution, then the platform is likely to be registered as an agent of the payment institution.

Reducing risks for investors

Regulation 2020/1503 stipulates that crowdfunding platforms must carry out a due diligence check on project owners and provide investors with a key project information sheet. Unlike a prospectus, the information sheet does not necessarily have to be approved by the competent authority (i.e. CySEC in Cyprus).

Crowdfunding platforms planning to operate cross-border under the regulation will need to develop a business continuity plan to ensure that, in the event of the platform ceasing to operate, critical services related to existing investments are not interrupted and contracts between the platform and its customers are properly managed.

In addition, platforms will need to integrate the compliance measures to prevent conflicts of interest, ensuring that they do not participate in any project on their own platform, nor do they accept projects from related parties. At the same time, related parties are not prevented from investing through platforms, provided that it is ensured that they are subject to the same rules as any other investor. In this case, the platform must disclose information about the acceptance of investments from related parties. For their part, loan facilitation platforms will be required to publish project default rates for at least the previous 36 months on an annual basis, as well as quarterly expected and actual default rates for all loans.

As with other regulated market participants, crowdfunding platforms will need to provide prudential safeguards in the form of equity, insurance policies or a combination of both. The platforms must have a reserve of at least €25,000 of own funds or an amount which is equivalent to 25% of the platform's fixed expenses for the previous year. If the platform executes payment transactions related to transferable securities, it must use the services of a custodian bank.

ESMA register

Regulation 2020/1503 stipulates that the authorisation and supervision of platforms is entrusted to the competent authority of each member state (in Cyprus, this is CySEC). These competent authorities are required to maintain close cooperation with the European Securities and Markets Authority (ESMA). In turn, ESMA is tasked with setting up a dedicated register where the general populace will have access to a wide range of information on all authorised crowdfunding platforms in the EU.

Regulation 2020/1503 facilitates the provision of cross-border services. It requires an authorised platforms to provide its home competent authority with a list of member states, where it intends to provide crowdfunding services. Following this, the home competent authority will inform the competent authorities of those member states of the intention of the platform to passport its services into that member state and the information will be included in ESMA's register. Significantly, Regulation 2020/1503 prohibits member states, other than the member state where the platform is authorised, from requiring the physical presence (office) of platforms in their territory.

Sophisticated and non-sophisticated investors

As with investment funds and alternative investment funds, Regulation 2020/1503 distinguishes between sophisticated and non-sophisticated investors. It introduces

different levels of investor protection measures that are appropriate for each of these categories. In the case of non-sophisticated investors, Regulation 2020/1503 requires that the platform must perform an investor engagement test. This requires the investor to provide various types of information and to ensure that the investor simulates their ability to bear losses calculated as 10% of its net asset value.

In case the investor refuses to provide such information or, the platform considers that the investor's knowledge, skills and experience are insufficiently sophisticated to assess risk, then Regulation 2020/1503 requires the platform to inform the investor that its services may not be suitable, issue a risk warning and receive confirmation from the investor that he/she understands this risk. Such risk warning procedure, including explicit confirmation from the investor must be followed each time a non – sophisticated investor makes a new investment in excess of €1,000 or 5% of the net asset value of the investor calculated in the above simulation.

Crowdfunding in Cyprus: The way ahead

It is clear that the current crowdfunding regime in Cyprus, whilst narrower in scope than Regulation 2020/1503, overlaps closely with the majority of its provisions. This is a significant boost for the crowdfunding sector in Cyprus. It confers a high degree of legitimacy on the current regime and offers comfort to existing and potential crowdfunding investors.

Regulation 2020/1503 provides for transitional arrangements so that persons providing crowdfunding services in accordance with their national law, and which now fall within the scope of the Regulation can adapt their business activities over time to ensure compliance. Such persons may continue to provide crowdfunding services that are included within the scope of the regulation in accordance with the applicable national law until November 10 2022.

In the case of crowdfunding platforms already authorised in Cyprus the transitional requirements should be minimal and low cost. Additionally, despite the fact that fintech is a rapidly changing sector, both crowdfunding platforms and potential investors can take comfort in the fact that they are unlikely to be caught off-guard by sudden legislative change.

In Cyprus, the CySEC established 'Innovation Hub' is mandated with determining the future requirements for new legislative and supervisory priorities. It regards consultation with the relevant stakeholders as a crucial part of this process and recognises that both businesses and investors value stability and that can only be good news for Cyprus's prospects as a crowdfunding hub.

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Residential sub-leasing and property management businesses face new regulations

In June 2020, the National Diet of Japan promulgated a law that regulates operators of residential sub-leasing businesses and residential property management businesses through newly established rules. This new law is intended to address certain problematic practices that exist in Japan's residential leasing market.

Background: growth in disputes

In recent years, disputes between apartment owners and sub-leasing companies stemming from misunderstandings concerning their contractual arrangements and risks associated with residential leasing arrangements have increased and become a social problem in Japan. The typical scenario underlying these disputes involves a sub-leasing company convincing a landowner to construct a new apartment building (generally funded with a bank loan) with assurances that the sub-leasing company would lease the entire building on a long-term, fixed rent basis.

Through this arrangement, the landowner (i.e. the future owner of the apartment building) would expect to receive lease payments under its master lease agreement with the sub-leasing company and avoid the risks associated with leasing the apartment building's units (which would be the sub-leasing company's responsibility). However, problems arise when the sub-leasing company encounters difficulties in leasing the apartment building's units, and consequently either requests a reduction in the lease fees payable under its master lease agreement with the owner of apartment building, or seeks to cancel the master lease agreement.

While a non-mandatory registration system for residential lease property managers was established by the government in December 2011, prior to the new law, there was no mandatory license or registration obligation for residential lease property managers in Japan.

A closer look at the new rules

The new law established rules focusing on two aspects of residential sub-leasing arrangements: sub-leasing activities and property management activities.

Regarding sub-leasing activities, the rules require all sub-leasing companies (i.e. master lessees under master lease agreements with apartment owners) to comply with a newly-created code of conduct. Under the code of conduct, sub-leasing companies must explain to apartment owners the important points of the master lease agreements and other relevant matters in advance of signing and provide the owners with stipulated categories of information in writing at the time of signing. This disclosure of information can provide owners with important information that they need to make informed decisions considering the relevant risks. Additionally, the code prohibits sub-leasing companies from making misleading advertisements and engaging in improper solicitations.

Regarding property management activities, under the rules, each 'residential lease property manager' (i.e. a person entrusted by the owner to perform comprehensive management of the owner's residential property) is required to be registered in a compulsory official registration system operated by the Ministry

of Land, Infrastructure, Transport and Tourism and must adhere to a code of conduct established under the rules. The new code of conduct for residential lease property managers includes obligations of explanation and delivery of documents similar to those for sub-licensing companies described above.

Confusion about the scope of the new rules

The new rules should help to address the social problem mentioned above; however, critics point out that the rules, when interpreted literally, are overly broad and this will result in confusion. Amendments to related ordinances and guidelines that were recently made public by the government and are to take effect on June 15 2021, provide new details of the registration system with additional official interpretations of the new rules, and this information will clarify the rules and resolve some of the confusion.

Interested parties should keep a watch out for changes to sub-leasing and property management practices resulting from implementation of the new rules.

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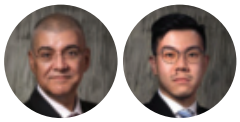

João Nuno Riquito and Belmiro Leong

Looking at perpetual bonds – the advantages of debt as equity

A recurrent subject and concern, these days, in the legal and financial advisory to corporations in Macau SAR, is that of addressing the requirements imposed by Section 206 of the Commercial Code for when the company's net asset value (NAV) drops below half the value of its capital.

> "Crowdfunding platforms will need to provide prudential safeguards in the form of equity, insurance policies or a combination of both"

Aside from the 'traditional' solutions of capital reduction/increase, quasi capital, asset revaluation and measures of a similar nature, it is worth noting that the issuance of perpetual bonds, whilst remaining one of the least used solutions, may in the circumstances, prove to be an excellent alternative.

Perpetual bonds are considered an equity instrument whose issuance contributes positively for the NAV of the company, as unequivocally demonstrated in paragraphs 16(a), 16(b) and AG13 of International Accounting Standard 32 (applicable in the Macau SAR *ex vi* the Administrative Regulation of the Chief Executive No. 42/2020);

From the perspective of the equity holders, the advantage may be considerable, given its (at least theoretical) non-diluting effect on shareholders who may not be willing or able to subscribe for the injection of new funds, whilst offering guaranteed remunerations prospect for the subscribing equity holders.

The issuance of perpetual bonds may be enacted by the means of a public subscription or a private placement. In the first case, the procedure must be done by a local underwriting agency in accordance with the Decree-law No. 32/93/M and the Circular No. 009/B/2019-DSB/AMCM of the Monetary Authority of Macao, with the final approval of the Chief Executive. Private placements are simply subject to compliance with the relevant provisions in the Commercial Code, and may be extraordinarily advantageous as part of an overall financing restructuring for private companies.

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DLT: theoretical possibilities hampered by practical legal limitations

With financial innovation in the agenda, it is becoming undeniable that decentralised financial technology (DLT) – of which blockchain is a subtype – is the centre piece that will underpin, and drive decentralised financial innovation as a truly transformative and foundational technology.

However, the pace and the extent to which the technology can flourish in all its theoretical potential and practical deployment relies heavily on the willingness of legislative powers to give statutory legal effect to DLT-based solutions when warranted. The legal world will recognise things and give them meaning in accordance with its own set of rules, which means that certain operations will not have their desired legal effect if the technology is not recognised by law to produce the intended legal outcomes.

For example, the potential to tokenise any asset and have the rights to such an asset be represented on a DLT has now been discussed at length, and while this is

true in theory, it may not be possible for a person to transfer certain objects in this way.

In jurisdictions where an object, such as a real estate asset, can only be transferred by execution of a deed or other public document and/or that require public registration of property rights, it is not possible to legally transfer property over such kinds of assets through tokenised instruments without an adjustment of the existing legal framework. The law will not recognise the transaction as valid for this purpose and, while other remedies may be available for the persons holding those tokens, they will not be able to claim the asset or any fraction of the asset in court.

It should in any event be possible to tokenise the economic interests in the asset which leads to the question of how those claims would be structured, considering that the asset does not have legal personality and cannot be a subject of rights and obligations *vis-à-vis* potential investors. This will probably lead to the conclusion that some form of special purpose vehicle (SPV) must be created depending on the alternatives available in the relevant jurisdiction and will invariably attract the legal regime applicable to such figure, whether or not it is desired by the technology driven promoters. Furthermore, it will become necessary to assess the type of instrument being created to represent the claims over the asset and the legal framework applicable to it.

If the objective is to structure a financial instrument or transferable securities, then in principle a whole lot of regulation should come their way. However, there is no certainty or clarity on how these rules would apply to these instruments, as they were created for a completely different paradigm of banking and financial services and their participants which is based upon centralisation. This is but one example from the many that could be mentioned.

In any event, as can be seen from the example, there are a number of legal constructions that are required to be put in place to make the innovative project work from a legal perspective, that would not be necessary from a purely technical and theoretical approach of the technology being implemented. Therefore, it becomes difficult to navigate DLT applications in the banking and financial system, if there is no real effort to provide legal certainty to market participants that are eager to put their proofs of concept into practice.

This effort should be two-fold to include legislative intervention to ensure that there is a clear legal pathway for the application of exemptions from existing rules and the granting of powers to supervising and regulating entities to be able to determine the application of those exemptions in practice. Otherwise, the line between legality and illegality will be blurred in most instances deterring significant investment, technology deployment and scalability of DLT solutions.

This is troublesome if one considers the potential revolutionary impact of DLT to optimise areas of banking and finance such as payments, clearance and settlement systems, fundraising, securities and financial instruments, custody, loans and credit, trade finance, know your customer (KYC), anti-money laundering, prevention of terrorist financing and fraud.

Surprisingly enough, while most EU countries have innovation hubs, only a handful have yet implemented regulatory sandboxes in which DLT solutions could be tested; and while the European Commission has presented its proposal for a regulation for a pilot regime for market infrastructures based on DLT, there is no certainty as to when the legislative process will conclude and the final text will be adopted, and even then the proposal foresees a five year experimental period before a definitive legal framework for DLT market infrastructures can be proposed by the European Commission.

Taking into consideration the importance of legal certainty as a base for the growth, implementation, and adoption of DLT-based solutions in banking and finance on a EU-wide level, and the challenges arising from international competition in this field by other countries, it is worth pondering if the EU and EU countries are not setting a pace that is too slow to answer the needs of this technology and the market participants' expectations.

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SLOVAK REPUBLIC

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Foreign companies set to face new income taxes

The Slovak Republic will be expanding taxation on income derived from controlled foreign companies (CFCs) to include individuals. The CFC rules implemented in 2019, concerned only controlling companies and not controlling individuals, and this is set to change in 2021.

The purpose of CFC rules for individuals is to ensure that dividends from a CFC are paid out in the Slovak Republic. Includible income from a CFC is a new type of taxable personal income introduced by the CFC rules. Includible income will be the annual income of the CFC, net of the corporate income tax levied in its resident country.

The new taxation rules will apply irrespective of whether an individual has actually received the dividends. The taxation will apply as soon as the individual becomes eligible to receive the dividends from the CFC or even if the CFC decides to re-invest the profits without a distribution to the individual. Determination of the includible income will not take into account any prior losses reported by the CFC.

To avoid double taxation of the same income where there is a chain of controlled companies, the received dividends for which the individual was already taxed as includible income from another CFC will be excluded from the income of the CFC.

Regardless of nationality, an individual who is tax resident in the Slovak Republic and liable to unlimited taxation can be considered a natural person controlling a CFC. This is any individual with a registered permanent address or place of normal residence in the Slovak Republic or whose habitual residence is in the Slovak Republic.

Place of normal residence means any type of accommodation not intended for occasional use and, considering all related circumstances including the individual's personal and economic ties to the Slovak

Republic, it is apparent the individual's intention is to reside permanently at such place of normal residence. A habitual residence in the Slovak Republic is where an individual is present in the Slovak Republic at least 183 days in a calendar year, whether consecutively or accumulatively spread out over the year (all days, even partial days, count toward the total).

A foreign company controlled by an individual will be a company that is domiciled abroad, where an individual either solely or together with related persons controls the foreign company or has direct or indirect participating interest, voting rights or is entitled to at least 10% of the dividends. At the same time, however, the foreign company must also be tax resident in a country which, for tax purposes, the Slovak Republic deems to be a non-cooperative jurisdiction without a double taxation treaty or where the foreign company's residence country has an effective income tax rate of less than 10%.

The effective tax rate is calculated as the ratio between the taxes levied on the foreign company in its residence country and its income. For example, if a foreign company is subject in its residence country to a nominal corporate income tax rate of 15% and reports an income of $100,000, but for a variety of reasons only paid $5,000 on this income, the effective tax rate will be $5,000/$100,000 x 100, i.e. 5%, which is lower than the legal 10% minimum required by Slovak law.

There will be several exceptions to the CFC rules; for instance, they will not be applicable where the total amount of includible income of an individual from a CFC does not exceed €100,000 in the respective tax period. However, if the includible income exceeds €100,000, the entire amount (not just the amount in excess of €100,000) will be included in the individual's tax base in the Slovak Republic.

Where the controlling person of a CFC is an individual as well as a legal entity (i.e. duplication of control of the foreign company), the CFC rules must be applied by the controlling legal entity according to the regime applicable to legal entities, and the CFC rules for individuals will not apply.

The CFC rules of taxation for individuals will apply to the foreign companies they control if their residence country deems the Slovak Republic as a cooperative jurisdiction for tax purposes and the individual can demonstrate that the company does in fact conduct business activities in the given country, and can prove the existence of business premises, activities, staff and equipment.

If an individual has includible income from a CFC that is tax resident in a cooperative jurisdiction, that income will be subject to a special tax rate of 25%. If the individual has includible income from a company that is tax resident in a non-cooperative jurisdiction, the tax rate for that income will be 35%.0

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Enabling bankruptcy-remote custody of crypto assets

As the interest of institutional and retail investors in crypto assets such as bitcoin or ether is gaining further momentum, the regulation of virtual asset service providers providing custody services for crypto assets (custodial wallet providers) has become a priority issue for regulators and legislators around the world. While some jurisdictions have put in place bespoke regulatory frameworks for custodial wallet providers, other jurisdictions still struggle to determine the right measures for a risk-based yet innovation-enabling regulation of custodial wallet providers.

The Swiss Financial Market Supervisory Authority FINMA, the Swiss watchdog for the financial industry at large, pursues a technology-neutral 'same risks, same rules' approach and applies its existing regulatory framework based on the activities pursued by a custodial wallet provider. The Swiss legislator is supportive of this approach and is ready to amend existing rules in order to ensure a robust legal framework for crypto assets and other fintech developments.

Customer protection: a growing international concern

A growing concern for national and international regulators and legislators is the protection of holders of crypto assets in the insolvency of a custodial wallet provider. As custodial wallet providers often do not require a banking or securities firm license in order to offer custody services for crypto assets, customers of custodial wallet providers lack the protection conferred by regulatory capital requirements, bank depositor protection schemes and other rules ensuring the preferential treatment of customers in the insolvency proceedings of a bank or securities firm.

Policymakers therefore increasingly call for adequate customer protection measures in the crypto space, including e.g. by requiring custodial wallet providers to publish unambiguous risk disclosures to promote transparency for customers or by ensuring that customer assets are held in a bankruptcy-remote manner protected from claims of other creditors of the custodial wallet provider.

Against this background, Switzerland is set to introduce an amendment of its insolvency laws which will enable the segregation of 'crypto-based' customer assets in the event of a bankruptcy of a custodial wallet provider. The amendment is part of a larger revision of Swiss law aimed at further enhancing the legal and regulatory environment for DLT-based projects in Switzerland. While some of the revisions have already been enacted in the beginning of the year, the segregation rules are expected to enter into force as of August 1 2021.

Segregation rules: applicability

The new segregation rules do not distinguish between different categories of crypto-based assets and apply in our view with regard to all types of tokens irrespective of their qualification as a payment token, asset token, utility token or a hybrid form of these tokens. However, in order to qualify as a 'crypto-based' asset, access to the tokens must be conveyed through a cryptographic protocol.

Furthermore, the custodial wallet provider must hold on behalf of its customers all cryptographic keys that are

necessary to access and dispose of the relevant tokens on the distributed ledger. If the customer independently holds some or all of the cryptographic keys that are necessary to access the tokens (for example as part of a multi-signature address), the tokens in question will usually not form part of the custodial wallet provider's bankruptcy estate, in which case the segregation rules are redundant. However, the customer will still be entitled to claim the cryptographic keys that are held by the (bankrupt) custodial wallet provider.

Individual vs omnibus custody

Custodial wallet providers either hold their customers' tokens in individual addresses on a distributed ledger or operate under an omnibus structure, meaning that customers' tokens are held collectively in one or several omnibus addresses on the distributed ledger.

In order for the segregation rules to apply, the custodial wallet provider must be able to allocate the tokens held on-chain to each of its customers individually or at least be able to determine the proportional entitlement of each of its customers to the tokens held in an omnibus address. It is sufficient if the customer-by-customer allocation is established at the internal books and records level of the custodial wallet provider rather than on-chain.

Irrespective of the custody structure used, the custodial wallet provider is required to keep the tokens available for its customers at any time and may not carry out proprietary or own-account transactions with customer assets. The custodial wallet provider is accordingly precluded from engaging in lending and similar commercial activities with the assets of its customers in order to ensure the customer privilege stemming from the segregation rules.

Committed to responsible innovation

With the implementation of the new segregation rules for custodial wallet providers, Switzerland proves once again that it is committed to be at the forefront of responsible innovation in the DLT space.

The new rules are expected to further strengthen Switzerland's position as a leading hub for DLT projects as they will enable Swiss-based custodial wallet providers to offer their customers a bankruptcy-remote custody of crypto assets, albeit at the cost of refraining from certain commercial activities.

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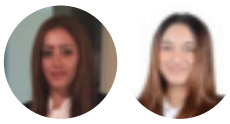

May El Ghamry and Patricia Fernandes

Analysing potential alternatives to Libor

As announced by the UK Financial Conduct Authority (FCA), Libor shall discontinue to be a benchmark for financial arrangements by the end of December 2021. Countless contracts worth trillions of dollars have binding Libor clauses which extend beyond 2021. Therefore, the transition to incorporate an alternate benchmark will demand considerable effort to assess the impact on firms, amend contracts and update systems. All Libor-based agreements that extend beyond 2021 will likely require certain amendments to accommodate the discontinuation of Libor.

Background

Libor has a critical role in the global markets because it is widely used as a reference rate for financial contracts and as a benchmark to assess funding costs and investment returns for a broad range of financial products. Variations in the 'spread' between Libor and other benchmarks indirectly act as a key indicator of changing investor sentiment in the global financial markets. The FCA included measures to make Libor a regulated benchmark and Libor played a vital role in facilitating the use of transactional data by the Financial Stability Board.

The reason for the FCA's decision to replace Libor was due to the 2012 Libor fraud, where several leading banks participated in manipulating the Libor benchmark interest rates to manipulate the market and boost their own profits. Libor could effectively end before 2021, if, the number of panel banks reporting to Libor which is currently between 11 and 16, fall below the required minimum of four banks. This could result in an immediate change to the reference to calculate interest rates. The replacement of Libor will not only impact the UK, but is expected to have global repercussions being that it is currently the mostly commonly used benchmark for calculating interest rates in the world.

Potential alternatives to Libor

In July 2017, the FCA confirmed that beyond 2021, regulators and market participants will not be able to rely on Libor. Since then, the market has been developing alternate ways, such as the use of risk-free reference rates (RFRs), that will replace the use of Libor. The two principal RFRs currently recommended are the Secured Overnight Financing Rate (SOFR) (for US dollars) and Sterling Overnight Index Average (SONIA) (for sterling).

SOFR is fast becoming the benchmark interest rate for dollar-dominated derivatives and loans. This transition is expected to increase long-term liquidity but also result in substantial short-term trading volatility in derivatives. SOFR relies strictly on transaction data consisting of a daily rate, called an 'overnight rate'. It is a risk-free rate because it is based on the treasury. SONIA is preferred as the primary interest rate benchmark for sterling markets and is used for overnight funding for trades that occur in off-hours and represents the depth of overnight business in the marketplace.

The key differences between the RFRs and Libor have implications which will affect the way the financial instruments referencing SOFR and SONIA are documented. SOFR and SONIA are based on a measurement of overnight borrowing costs, hence, they are risk free, whereas Libor represents the cost of interbank for a specific period of time, therefore, it takes into account a certain amount of credit and liquidity premium.

Transitioning to a new benchmark rate will be practically difficult and will create issues for the trillions of dollars' worth of Libor based agreements that are not set to mature until after Libor's discontinuance (i.e. they go beyond 2021) including the commonly used three-month US dollar Libor. However, the replacement index, once decided upon, can be incorporated into the agreements with the appropriate

"It is advisable to insert clauses in various arrangements and agreements to prepare for the resulting effect of the cessation of Libor"

adjustments. Documentation for these existing agreements will need to be amended by the end of 2021, in order to incorporate the change. As for new financing agreements, institutions are advised to include the appropriate alternative method for how rates will be handled going forward

In a situation where Libor ceases to be temporarily available, loans based on the standard Loan Market Association (LMA) form contain a provision that covers such a situation wherein the lenders cost of funding or a stipulated reference bank rate is used. This fallback however presents further issues as it provides only temporary relief for the situation of Libor unavailability. The FCA will not require reference banks to continue publishing rates as this fallback will be costly in the long run.

To ease the transition of the discontinuation of Libor, the LMA introduced an optional 'Replacement of Screen Rate' clause which gives parties the flexibility to choose a replacement benchmark following Libor with a majority-lender consent. Pursuant to the introduction of the Replacement of Screen Rate clause, the Asia Pacific Loan Market Association (APLMA) incorporated a modified version of the LMA's Replacement of Screen Rate clause in its own agreements stating that majority of lenders must approve a change of benchmark, requiring unanimous lender consent if the benchmark would result in a reduction in amount of interest payable.

From January 25 2021, all new derivatives contracts referencing the International Swaps and Derivatives Association (ISDA) definitions will incorporate fallback provisions, which are contained in a new protocol and supplement that ISDA issued on October 23 2020. For derivatives contracts referencing the Libor, the fallback provisions will apply once FCA determines that the Libor rate no longer reflects the underlying market.

Further actions to be taken

Many regulators and financial advisers are in pursuit of obtaining a strategy to implement the anticipated transition. They have also been requesting various firms to prepare for the Libor discontinuance to ensure that the board and senior management of these organisations understand the risks associated and are taking appropriate steps to ensure a proper transition of the RFR by the end of 2021.

It is unlikely that many existing contracts contemplate the cessation of the Libor rates or any circumstance where the Libor rates are not applicable anymore. Failure to amend these provisions will bring complications and significant legal risk. Therefore, it is advisable to insert clauses in various arrangements and agreements to prepare for the resulting effect of the cessation of Libor.

Until there are robust alternatives in place, market participants need to consider, on a case-by-case basis what action to take in relation to current transactions being that there is not yet a consistent market-wide approach. The interests of lenders in the loans market, investors in the debt capital markets and of market participants in derivatives, including interest rate swaps, differ, and so their preferred approach also differs.

In light of the cessation of Libor in less than 10 months, a number of clients including asset management, banks and financial institutions are looking to tackle the implications of the replacement of Libor in their financing arrangements and agreements.

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No limits to non-fungible tokens

Just about anything can be bought as a non-fungible token (NFT), whether it is a cyberpunk pixelated character, a painting or even a tweet. NFTs have taken the fashion and art world by storm, changing the way products have been sold traditionally into a decentralised and digital format.

In April, a virtual hoodie was bought as an NFT for £19,000 ($25,000). Overpriced, the streetwear fashion label, sold the virtual product to an anonymous bidder on the digital art marketplace Blockparty.co. The buyer can wear the garment online by scanning a code.

Meanwhile, the rock band Kings of Leon made a splash with its album which was sold as a NFT, and in March, Twitter CEO Jack Dorsey sold his first tweet as an NFT for more than $2.9 million. It is evident that the risk appetite of NFTs is growing, but is it just a fad or a trend that is here to stay? Only time will tell. For lawyers, the fun part will be how to figure out all the legal implications of NFTs, from intellectual property and taxation to data privacy and securities law.

Bitcoin mining in China

According to a study published in Nature Communications, the growing energy consumption and carbon emissions of bitcoin mining have the potential to substantially undermine global efforts in sustainability. Around 80% of the world's bitcoin mining occurs in China, where ironically, cryptocurrency trading has been banned since 2017.

The study estimates that without any policy interventions, China will generate 130.5 million metric tons of carbon emissions by 2024. This trend would contradict President Xi's commitment to reduce carbon dioxide emissions by at least 65% from 2005 levels by 2030 and to be carbon neutral by 2060. However, in Inner Mongolia, where most of the bitcoin mining action happens in China and is powered by coal generated electricity, the provincial government has banned all cryptocurrency mining farms as of April 1, so miners have to move elsewhere in China or go overseas.

On May 21, China's State Council's Financial Stability and Development Committee vowed to crack down on bitcoin mining in its plan to prevent and control financial risks, marking the first time the highest level of the Chinese government has targeted bitcoin mining activities.

Crypto in numbers

56 million	number of Coinbase users globally
$292 billion	market cap of Ethereum
210,000	amount of bitcoin blocks that needs to be mined for bitcoin's value to be cut in half
10 minutes	amount of time needed to mine one bitcoin
71.4 million	number of blockchain wallet users worldwide
400,000	number of crypto scams in 2020
69 cents	all-time high of dogecoin this year

Heard something that deserves a mention in Closing Conditions?
Let us know at john.crabb@euromoneyny.com

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