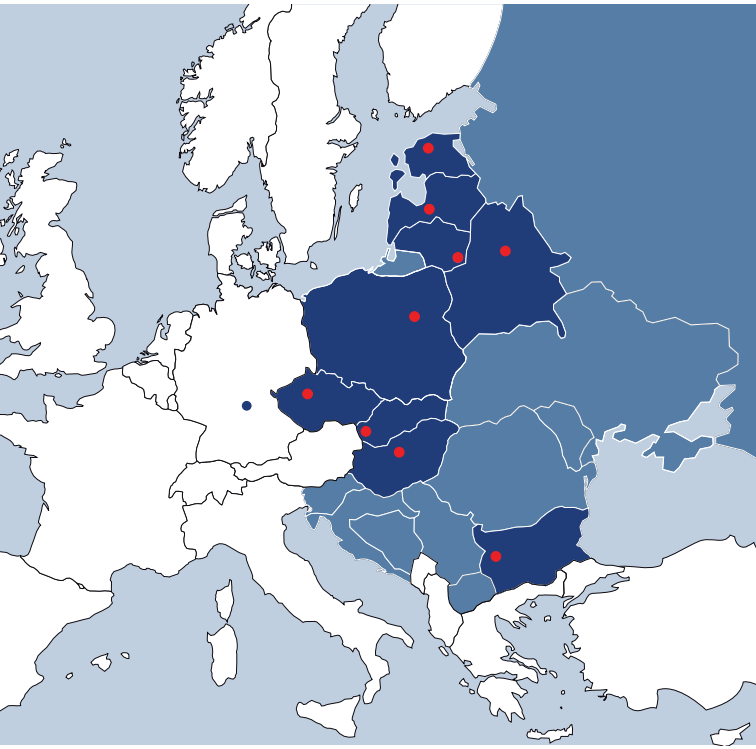

Baltic Banking and Finance Law Survey 2015

bnt
attorneys-at-law

Contents

Introduction

In the past five years, the financial sectors in the three Baltic States have undergone a period of restructuring. The regulatory framework has been affected and changed by introduction of new EU standards, but it remains fragmented in many areas. This survey provides an overview of the main areas relevant for financial institutions in the practice of banking and finance law, taking into account the experience of lawyers advising financial institutions in Latvia, Lithuania and Estonia.

bnt attorneys-at-law is present in these markets for more than ten years, offering insight and knowledge of the local legislation and jurisdictions. The bnt survey Banking and Finance Law Baltic States serves as a starting point for businesses active in this region or planning to do so.

All bnt international surveys are available at www.bnt.eu

Theis Klauberg
Partner
bnt International Practice Group Finance & Tax Law

Estonia

A. Framework

I. Banking System

The banking industry consists of Estonian all-purpose banks, as well as branches and representatives of foreign credit institutions. The Central Bank, the Bank of Estonia (Eesti Pank, www.bankofestonia.info) situated in Tallinn, sets monetary and banking policy and assists the Financial Supervision Authority in matters of banking supervision.

The Bank of Estonia is an independent state institution. While it is obliged to report to the Parliament of Estonia, it is not subordinate to the Parliament or to any other state institution. The only institution authorised to issue instructions to the Bank of Estonia is the European Central Bank. The Bank Council appointed by the Parliament is independent in its activities. The Bank Council consists of a chairman and seven members whose term of office lasts for five years. The chairman is appointed by the Parliament on a proposal from the President of the Republic of Estonia. Appointment of members of the Bank Council is also by the Parliament but on a proposal from the Chairman of the Bank Council.

II. Banking Supervision

Supervision of banks is exercised within the framework of consolidated supervision, which includes supervision of the insurance and stock market, by an independently operating Financial Supervision Authority (www.fi.ee) which cooperates with the Bank of Estonia.

The Financial Supervision Authority enjoys broad information rights. Sources of information for the Financial Supervision Authority among other state institutions are, in particular, the Bank of Estonia and the Ministry of Finance. The Financial Supervision Authority is obliged to provide information to the Ministry of Finance. Confidential information may only be disclosed to state authorities conducting an investigation or supervision proceedings.

The Financial Supervision Authority is authorized to

issue regulations and resolutions. In particular, it issues a license for establishment and operation of banks, provided that the requirements of the Credit Institutions Act, including a minimum capital of five million EUR and reliability of the management, are fulfilled.

There is no general licence requirement for opening a representative office. Representative offices can be opened without a licence from the Financial Supervision Authority, as long as there is a business plan, a power of attorney for the acting representative in Estonia, as well as documents which prove the existence of the represented foreign bank in their home country. The articles of association of the bank must also be filed with the Financial Supervision Authority, as well as the address and other contact details of the representative office. However, the representative office may not carry out business activities. Opening an independent branch with full business powers requires a license from the Financial Supervision Authority.

An application must be filed under the Credit Institutions Act. A licence is issued by the Financial Supervision Authority within six months after filing of all application documents.

B. Accounts and Financial Transactions

I. Account

Bank accounts can be opened as savings accounts, current accounts or in any other form in any currency. The provisions of the Law of Obligations Act regulating the account management agreement include the account owner's right to issue instructions and the duties of the party managing the account, including the obligation to pay interest on deposits and to maintain confidentiality, as well as documentation requirements. These rules may not be waived to the detriment of the consumer.

Dealing with money in general is subject to the far-reaching provisions of the Estonian Credit Institutions Act and Money Laundering and Terrorist Financing Prevention Act (the Money Laundering Law). The Money Laundering Law finds a use for all kinds of services that even remotely have anything to do with dealing with money. In addition to banks these include mainly

gambling institutions, exchange offices, as well as attorneys, notaries and suppliers of other legal services in financial or real property transactions. In order to promote transparency the Money Laundering Law contains strict due diligence obligations, which include customer identification and acquisition of information on the business relationship and about the purpose and nature of the transaction. Transactions indicating money laundering must be reported to the Financial Intelligence Unit.

The obligation to keep banking secrecy, which continues even after the end of a business relationship, can be revoked under disclosure obligations. Information that is already public or accessible to third parties does not fall under banking secrecy. Protected information can be disclosed to third parties with the written consent of the person concerned. The bank must disclose information if requested by the state. A breach of banking secrecy obliges the bank to pay damages.

II. Financial Transactions

Payment transactions are carried out under the regulations of the Bank of Estonia. Regulation of payment instruments includes regulations on bank transfers, electronic payments and liability of the participants. The payment method is set by agreement between the banks, service providers and customers.

The Bank of Estonia operates the TARGET2-Eesti interbank payment system, which is for real-time settlement of cross-border express payments, Due to migration to SEPA in February 2014, the retail payment settlement system called ESTA has closed down and the banks themselves choose the service provider.

C. Credit and Security

I. Forms of Credit

Estonian civil law distinguishes between loan agreements, credit agreements, and consumer credit agreements.

By a loan agreement, one person (the lender) undertakes to lend a sum of money to another person (the loan recipient), and the loan recipient undertakes to

repay the same sum of money. The concept of a credit agreement is wider than a loan agreement. A credit agreement includes all agreements which constitute giving a paid credit to another person. The concept of credit agreement does not cover loan agreements in which the loan recipient does not pay interest. The provisions of a loan agreement apply also to credit agreements.

A notice period of two months applies to loan agreements entered into for an unspecified term in the absence of other agreement.

Interest is always paid on loans for business activities. For loans other than commercial loans, interest rates are only subject to agreement between the parties. If there is no contractual provision on the interest rate, the usual rate for similar loans applies. The law does not contain a fixed interest rate but only requires that this has to follow the interest guidelines of the European Central Bank. The interest rates of the Bank of Estonia must be established on time and published accordingly.

Credit brokerage agreements are subject to special procedural requirements. A credit brokerage agreement must be in writing. A credit brokerage agreement and a credit application cannot be contained in one document. Failure to follow this rule leads to invalidity of the agreement.

Issuing and brokering consumer credit, as well as providing other financing help and overdraft credit to consumers, i.e. to natural persons who are not acting in independent business activity, are regulated in detail by law. Violation of the requirement of written form or the information obligations of the creditor generally invalidates a consumer credit agreement, but in some cases becomes effective when the consumer receives the relevant agreement. If the agreement contains no information about the interest rate, the statutory interest rate applies. Interest for default in payment which exceeds the statutory interest rate may not be agreed. The consumer may, within seven days after receiving notification of the withdrawal right but no later than one year after accepting the agreement, withdraw from the agreement and must then repay the credit within two weeks.

In this case the consumer can also withdraw from a sales agreement economically linked to the consumer credit agreement. The credit can be repaid at any time, whereas interest or compensation for the remaining period until maturity is not paid. In the case of linked agreements the consumer can give objections against the creditor arising from the sale agreement. The creditor may cancel the agreement if the consumer is wholly or partly late with three consecutive payments and a two-week period after delivery of a warning with a notice of threat has expired. Agreements deviating from the statutory consumer protection provisions to the detriment of the consumer are ineffective.

Leasing business can be operated by banks and leasing companies. Under the statutory definition of lease agreement the lessor undertakes to acquire the leased item and hand it over to the lessee, while the lessee undertakes to make lease payments. The risk of accidental damage or loss of the leased item transfers to the lessee with delivery of the item. The lessee is the holder of warranty claims against the manufacturer. Claims against the lessor are only possible if the lessor himself chose the lease object or the lessee is a natural person and the lessor has reasonable knowledge relating to the object. In the case of withdrawal from the purchase agreement or loss of the lease object both parties to the lease agreement may terminate the agreement without notice.

II. Security

The most important means of security is a mortgage, which is established by a notarised security agreement and registration in the Land Register. A mortgage is non-accessory and can therefore be independent of the existence of a secured claim. For this reason a separate transfer of a mortgage and a secured claim is possible. A mortgage can also be established in favour of the owner of the property. An owner mortgage also arises upon payment of the claim when the owner acquires the mortgage.

At the request of a creditor in a court of competent jurisdiction, enforcement of a mortgage occurs if the debtor does not fulfil its obligations. This takes place through foreclosure or compulsory administration. The extent of satisfaction of the secured claim is determined

by the sequence of entry, where the principle of priority applies.

A pledge right is created by an agreement between the parties and the transfer of goods to the pledgee. The pledgee may use the pledged object only with the pledgers consent. In addition, the pledgee bears the burden of maintaining the object at own cost. A written agreement is required if the value of the object exceeds 50 EUR. Establishing several possessory pledges on a movable object is naturally impossible. However, when a pledged movable object is encumbered with several security rights, the rankings of the security rights are specified according to the principle of priority, as the ranking of the time of creation of the secured claim prevails. The pledge ceases in case of loss of the object or if the pledgee acquires title to the goods.

The pledge right plays a role in banking practice only in respect to securities. In this context it should also be noted that a pledge of shares in a public limited company must be certified by a notary and the management board must be informed of the pledge.

A registered security right (over movables) can be established over all items that are in a public register, i.e. objects including commercial and intellectual property, as well as vehicles. A registered security is created on entry in the register in question depending on the type of object, for example in the commercial pledge register, the register for industrial property, motor vehicle, ship or plane registers, which are all maintained as public registers. Objects of registered security remain in the possession of the pledger.

A commercial pledge, which is important in practice, is established over all existing and future movable assets of a company, including movables and future claims against third parties. Registration and a notarized contract are required. A commercial pledge is not dependent on the underlying claim and can thus be established as an abstract means of security without an existing claim. If the pledger disposes of pledged goods in the course of ordinary business, the pledge on the object ends, unless it is not considered a significant part of the asset. The same applies to acquisition in good faith by third parties. Transfer of ownership or sale under (extended) retention of title do not play a significant

role in practice but are legal institutions recognized by doctrine.

Another means of security are liens. These can be established in three ways: as a pledge, as a registered security over movables, or as a pledge of securities. Enforcement is carried out by the creditor whereby the object concerned is sold at public auction. The auction may take place within one month after notification of the auction to the debtor.

Suretyship is established by entering into a contract of surety. Under a suretyship contract the surety undertakes to be liable for the obligations of the obligee. Suretyship can be given for debts and other claims. It is accessory depending on the existence of the obligations of the obligee. Suretyship can be undertaken for a future liability only when it is already adequately defined for such a purpose. If the surety is a consumer, both the claim and the amount of the guarantee sum must be determined. Failure to follow this requirement leads to invalidity of the surety contract. In addition, a consumer surety contract must be in writing. Violation of this procedural requirement, as well as failure to comply with other statutory provisions, can be cured through performance. In principle, the obligee and the surety are equally liable unless the right to recourse has been specifically agreed. In this case the creditor can take legal action against the obligee and only if unsuccessful may resort to the surety. The creditor has an information obligation to the surety regarding fulfilment of the obligation by the obligee. Objections against the creditor are available to the surety to the same extent as for the obligee himself. This does not apply when the objections are highly personal in nature, so that they can only consist in the person of the obligee. The surety can take recourse from the obligee to the extent in which the surety met its obligation with the creditor. If the surety contract is concluded indefinitely for a future claim, the surety can terminate the contract at any time. Fixed-term surety contracts end with the deadline. Otherwise, suretyship expires in accordance with its accessory nature in the amount in which the secured claim expires.

An additional means of security is guarantee. A guarantee contract cannot be concluded with a consumer. This is partly because it would be contrary to consumer protection, because a guarantor has more

limited opportunities to refuse payment compared to suretyship. A guarantor can refuse payment to creditors only if their objections are based on the guarantee contract. A guarantee is non-accessory and its existence is independent of the secured claim. A person obliged by guarantee is entitled to recourse against the debtor of a claim only by virtue of a special agreement in the guarantee.

D. Capital Markets Law

I. Securities Law

The Tallinn Stock Exchange is the only stock exchange in Estonia. The stock market, investment activity, securities trading as well as the activities of commercial operators, protection of investors, securities issuance and registration are regulated by the Securities Market Act and the Central Register of Securities Act. In addition, decrees of the Ministry of Finance must be followed.

Administration and settlement of securities transactions are carried out by the Central Securities Registry. Supervision of the exchange market is exercised by the Financial Supervision Authority. In contrast with corresponding laws in Latvia and Lithuania, the area of application of the law includes the deposit guarantee fund as well as investment and pension funds. The Securities Market Act contains provisions for regulated markets and also regulates the purchase and sale of securities in general. The requirements for admission to trading on the Tallinn Stock Exchange are determined by the Tallinn Stock Exchange Rules.

The market is divided into four lists:
1) main list;
2) secondary List;
3) bond list;
4) fund list.

A decision on listing a company is made by the listing body of the Tallinn Stock Exchange within three months after the start of the listing process. The process starts with filing of application documents. These contain, for example, an extract from the Commercial Register and recognition of the stock exchange rules.

Foreign applicants must meet additional obligations:

- to disclose all business activities over the past three years;
- to give the Tallinn Stock Exchange information about business activities;
- if the issuer is listed on some other stock exchange the issuer discloses information on that stock exchange;
- to provide at least one paying agent which is a financial or credit institution in Estonia.

Admission to trading even before final listing on the stock exchange is possible as a preliminary step before listing and is also used to prepare the listing to commencement of trading on the Secondary list. Permission to do so is also granted by the listing body.

II. Investment Business

The legal basis for establishing and operating investment funds can be found in the Investment Funds Act. The law provides two possible types of fund: common funds and funds established as public limited companies. Investment funds invest in fund shares, organise distribution of profit among the shareholders and operate the marketing of their funds. In 2013 one fund was established as a public limited company and 31 funds were contractual funds registered in Estonia.

If a fund is established as a public limited company, the fund company must enter into a management contract with a fund management company. Fund management companies must be established as public limited companies. These invest on their own behalf or on behalf of managed funds, depending on how the business agreement was concluded. The seat of the company must be in Estonia; alternatively the company should maintain a branch in Estonia registered with the Commercial Register.

Permission to start business as a fund company is issued by the Financial Supervision Authority. A licence is granted only under strict conditions. In addition to the requirement of a minimum value of shares, further demands are placed on the executive board for the operation of the fund company; in particular the members of the management board of the fund company must meet high personal requirements regarding their qualifications and personal suitability.

III. Pension Funds

A particular type of investment fund is the pension fund. A distinction is made between mandatory pension and supplementary pension. The Funded Pensions Act contains framework conditions and procedural requirements for making a payment into the fund. Depositors are persons who secure their pensions through contributions to a pension fund and obtain an additional source of income from distributions from the fund on retirement.

Payment into the mandatory fund is from the State Pension Fund or through an insurance company. Payment into a supplementary fund is secured by a voluntary pension fund or voluntary pension insurance. Both funds exist as contractual funds. Pension fund units can be acquired by natural persons or pension management companies. Pension fund units cannot be further transferred or burdened.

Latvia

A. Framework conditions

I. Banking system

The banking business in Latvia consists of the Bank of Latvia, many active Latvian banks, branches and representative offices of foreign credit institutions. In general most Latvian banks are universal banks.

The Central Bank is the Bank of Latvia (Latvijas Banka, www.bank.lv) situated in Riga. Its task is to determine and implement monetary policy with the aim of maintaining price stability. By determining policy requirements for amounts of minimum reserves, for open market and other policies the Bank of Latvia influences the financial system and issues and controls decisions and decrees issued to serve this aim. Additionally it supports the Financial and Capital Market Commission in supervising banks and provides analytical reports.

The Council of the Bank consists of eight members, all appointed by the Parliament for a period of six years and is independent in its activities.

II. Bank supervision

The establishment and management of credit institutions and representative offices is subject to supervision by the Financial and Capital Market Commission (www.fktk.lv), which also supervises the activities of insurance companies and other participants in the financial and capital market and publishes analysis of the market under its supervision. The Commission has various rights to obtain information and perform inspections and may install safeguard measures in case of breaches of financial and banking supervisory obligations by market participants.

A licence to engage in banking activities is issued when the legal requirements are met. These include requirements for sufficient minimum capital of 5 million EUR and trustworthiness of the management. The same applies to foreign credit institutions operating through a branch. Additionally, a foreign credit institution has to prove that it has been in the business of a credit

institution for at least three years. This does not apply to a credit institution domiciled in a WTO member state. Credit institutions must be registered only as joint stock companies (akciju sabiedriba).

Representative offices may not perform business activities. Licensing the business of foreign currency exchanges, if not performed by credit institutions, is the responsibility of the Bank of Latvia. Credit institutions with their main seat in an EU Member State or in a state of the EEA may set up establishments without the need for permission in Latvia. They can do so after informing the Financial and Capital Market Commission and filing documents and information as defined by law. Supervision in these cases is performed by the supervisory authority of the home country of the mother company.

B. Accounts and payment transactions

I. Accounts

To open an account the prospective owner of the account must fulfil the formalities of identification. Agreements with credit institutions include standard general terms and conditions, although these are not unified between credit institutions.

Deposits are considered to be loans. In practice a bank account can be opened as a savings account, a deposit account, a current account and a credit card account as well as an escrow account in any currency. Cancellation of a deposit account concluded for an indefinite period is usually possible on giving prior notice unless contractually agreed otherwise. In the case of suspicious transactions, the bank must block the account and inform the money laundering prevention authority.

II. Payments

The information obligations of the credit institution in payment transfers as well as the obligations of the sending and receiving institution are regulated by the transfer regulation implementing EU payment transfer directive 97/5/EC. Additionally obligations to inform the state authority responsible for prevention of money laundering in case of suspicious transactions must be observed in line with the Law on Money Laundering

and Terrorist Financing Prevention. In practice, online banking payments are important in addition to written payment instructions and credit card payments. Payments by cheque play an insignificant role.

Payment settlements for non-cash transactions are organised by the Bank of Latvia in line with payment settlement regulation, by using interbank settlement systems: an electronic clearing system, which as an automated clearing house processes only electronic documents, is used for settlements of retail business transactions, while a real time gross settlement system is set up for large interbank transactions, for open market transactions and other transactions processed by the Bank of Latvia. Minimum requirements for electronic payment system transactions are set according to recommendations by the Bank of Latvia.

Apart from credit institutions, payment services can be provided by E-money institutions, the postal services provider, payment institutions, and the central banks of the EU, Latvia and other states and by Latvian state institutions.

A payment institution is a commercial legal entity holding a separate licence for involvement in payment transactions and is subject to supervision by the Financial and Capital Market Commission. A payment institution can be established as a limited liability company and depending on the type of payment services the minimum capital requirement starts at EUR 20 000.

C. Credit and Security

I. Forms of Credit

A loan is considered valid when the amount of the loan is transferred to the borrower with a duty to repay it. A loan agreement is valid if both parties have agreed on the amount. Under a loan agreement the lender is obliged to provide the loan and the borrower is obliged to repay the same amount.

Loans from credit institutions (bank credits) involve special form requirements: a credit agreement must be in writing, with a description of the parties, the amount and purpose of the credit, disbursement of the loan

and repayment schedule, interest rate and calculation method, collateral and all other conditions. The interest rate can be set by agreement between the parties. Absent such agreement, the interest rate as prescribed by law applies: in general 6%. However, there are exceptions to this rule: in the case of purchase, delivery of goods and provision of services the rate is 8% plus the base rate, while in consumer contracts it is 6%. The base rate t is subject to change every year on January 1 and July 1 and set according to main refinancing rate of the European Central Bank on January 1 and July 1 respectively. . Currently the base rate from 01.01.2015 is set at 0,05%. Interest may be calculated on the outstanding amount of interest payments not made for at least one year. If there is no contractual agreement on repayment maturity and the interest rate is higher than set by law, the debtor can terminate the contract on three months' notice. This right can be used after expiry of six months from signing the contract.

In case of consumer loans (i.e. loans to natural persons who do not use the loan for commercial activities) in the form of deferred payments, loans in cash or in any other form of financial services, additional formal requirements must be observed as to documentation concerning the conditions for the loan. In case of missing details on the interest rate and other costs, only the interest rate as prescribed by law (i.e. 6% plus base rate) can be applied. The legal consequence of breach of the form requirements is invalidity of the contract. Consumers can repay the loan at any time as well as withdraw from the contract.

Financial leasing operates through credit institutions and leasing companies on the basis of contracts between the parties. These usually cannot be terminated during the contract term. Latvia is a member state of the UNIDROIT Leasing Convention.

II. Security

A mortgage becomes valid when the agreement is registered with the Land Book. In practice it is reasonable to do so along with background checks on the mortgagor as well as the relevant real estate. This is because mistakes originating from Soviet times can still be seen in the land book registers, while existing tax debts can be an issue. A mortgage is accessory.

An agreement on a claim secured by mortgage is concluded as a mortgage agreement with a statement of the purpose of the collateral and must be in writing. Each novation of the claim for which the collateral is registered with the land book must be registered with the Land Book, otherwise it is binding only on the parties and is not binding against third parties. For complete deletion of a mortgage it is not enough that the claim secured by the mortgage no longer exists. In order to come into effect in relation to third parties the deletion must also be registered in the Land Book. The priorities of secured claims are established according to the time of registration.

Establishing a surety requires written form. In addition, credit institutions occasionally require sureties to be in the form of a notarial deed. The surety provider can use the right to require the debt to be recovered from the debtor in the first place, unless that right has been explicitly excluded. A surety is accessory and in case of payment the claim is transferred to the surety provider. For a surety agreement that is limited in time, the surety provider is released from the surety if a claim has not been brought within the agreed time. In textbooks and in court practice the legal term “guarantee” is also used. However, this is not separately known by Civil law, so that unless expressively agreed otherwise, both surety and guarantee are seen as synonyms.

In practice the most important pledge of movables is the commercial pledge, i.e. registered pledge rights on movable tangible assets and rights, but only as a general rule if those assets and rights are owned by a commercial entity, with certain exceptions relating to some other assets. A commercial pledge is established on registration with the public commercial pledge registry supported by an application signed as approved by a notary based on a commercial pledge agreement and on agreement as to the provenance of the secured claim. Encumbrance of assets as an aggregate of items is possible. For registration of a commercial pledge on assets that require separate registration (e.g. cars and airplanes) notice of pledge must also be registered in the respective registry. In the case of several pledges, priorities are established in accordance with the time of registration. It is not possible to pledge assets that might be subject to a commercial pledge, in accordance with other rules on pledges, including rules on pledges

in accordance with the civil law. The protection in case of breach of the commercial pledge contract only in exceptional situations might be questionable because the information in the commercial pledge registry is binding towards third persons. As rights under a commercial pledge end with purchase of the assets by a third party acting in good faith, protection is not absolute. In practice, only in exceptional cases can a third party rely on good faith because the commercial pledge registry is easily accessible on the Internet. Pledged assets can be sold only with written permission from the pledgee. Sale of pledged assets is by auction, or by ordinary sale if explicitly agreed in the commercial pledge agreement.

The importance of a possessory pledge is limited, both due to practical drawbacks because change of possession of the pledged asset is required and because of unclarified legal issues concerning establishment of the pledge, especially relating to establishment of a pledge through the mere fact of possession of an asset by some third person (creditor). Also of no practical importance is a usufructuary pledge, which along with movables can also be used for real estate and where the creditor is entitled to benefits from use of the pledged assets.

Reservation of title and assignment by way of security are possible, though rarely used in the practice of credit institutions - its function is taken over by the commercial pledge. The level of protection of an assignee and the relation of reserved, assigned property to the commercial pledge is not fully clarified.

Registration and validity of financial collateral in favour of financial institutions and public bodies, basic collateral with the exception of cash are regulated by the Law on Financial Collateral. In line with Directive 2002/47 EC on Financial collateral, the law lays down conditions that there are no additional requirements for registration and validity of collateral. Sale of financial instruments can also be by way of sale or take-over and subsequent settlement of its value against claims.

D. Capital markets law

I. Securities Law

The Stock Exchange and stock Exchange transactions are regulated by the Law on the Stock Exchange. The Riga Stock Exchange (www. nasdaqomxbaltic.com) is part of the NASDAQ OMX alliance of the Baltic securities markets, NASDAQ OMX Group Inc. being the largest stock exchange company worldwide. Provisions for issuance, registration and trading with securities are included in the Financial Instruments Market Law, which also determines the obligations of the parties involved, together with other legal acts, including the stock exchange regulations. The Financial Instruments Market Law implements existing Community legal norms in areas of capital and financial instruments and regulates transactions in capital markets as well as supervision of market participants and transactions performed, rules of prudent behaviour and investor protection. With implementation of the single passport principle on licensing requirements for investment companies the holders of a licence from another Member State may provide investment services in Latvia. Transaction settlement, custody and management of securities are through the central depositary or the Bank of Latvia. The Financial and Capital Market Commission performs supervision of trade in securities. Investment brokers may start their activities only with a licence from the Financial and Capital Market Commission.

II. Investment Business

The investment business in Latvia can be performed by investment management companies or by alternative investment management companies regulated by the Law on Investment Management Companies or by the Law on Alternative Investment Funds and their Managers. The Law on Financial Market instruments along with the Law on Investment Companies sets standards and regulates the activities of collective investment undertakings, whereas the Law on Alternative Investment Funds and their Managers deals with alternative investment funds such as private equity, real estate and other funds not falling under the definition of a collective investment undertaking.
Both types of investment management company must

be registered with the Financial and Capital Market Commission, which also supervises them.
An alternative investment fund can be established as an aggregate of assets, limited partnership or as a joint stock company. An alternative investment fund can be organised as an open-ended or closed-ended fund and must be registered with the Financial and Capital Market Commission. Sub-funds for each fund are permitted.

III. Pension Funds

Private pension funds are investment funds with the only purpose of investing funds voluntarily provided by the members of the fund or other persons on behalf of those members with the aim of securing an additional pension on top of the pension provided by state pension funds. Private pension funds are regulated by the Law on Private Pension Funds setting standards and requirements for fund management. Private pension funds can be constructed as open-ended or closed-ended funds with one or several pension plans, each plan being subject to registration with the Financial and Capital Market Commission. A closed fund can be established by an employer through an agreement on collective pension fund membership. An open fund can be established by a bank with an EU banking licence, or by a life insurance company licensed in the EU. Private pension funds are subject to regulatory supervision by the Financial and Capital Market Commission. Management of pension plans can be performed only by a licensed credit institution, a life insurance company, an investment brokerage company or an investment management company. The savings of pension funds can be deposited only with a licensed credit institution or investment brokerage company.

Lithuania

A. Framework Conditions

I. Banking System

The Banking System consists of the Bank of Lithuania, commercial banks, credit unions, payment institutions and other financial market participants.

The Bank of Lithuania (Lietuvos bankas, www.lb.lt) is the Central Bank of the Republic of Lithuania (the Bank of Lithuania/the Bank). The Bank is independent in its actions. Since the accession of Lithuania to the European Union, the Bank forms part of the system of European Central Banks. Mainly it determines monetary policy in order to maintain stable prices as well as supervising financial institutions, issuing licences for the provision of financial services, investigating disputes between consumers and financial market participants and providing recommendations on how a particular dispute between a consumer and a particular financial market participant should be settled. The Bank of Lithuania also supervises the insurance market and markets in financial instruments.

Banks licensed in the Member States of the European Union or the European Economic Area may provide financial services in Lithuania without founding a branch. Additionally, specialized banks may be established in the field of electronic monetary transactions and issue or acquisition of payment instruments. The majority of non-cash settlements pass through payment systems of the Bank of Lithuania. A significant number of people use services of commercial banks and credit unions, while the Bank of Lithuania supervises these credit institutions by issuing operating licences, monitoring their financial situation and operational risks, taking measures so that these risks remain at an acceptable level and preparing and publishing banking sector reviews.

II. Bank Supervision

Financial institutions including banks have a duty of disclosure as well as other obligations to the Bank of Lithuania, which may by law impose sanctions for breach of those obligations.

The Bank of Lithuania approves the foundation of a particular bank. In Lithuania, banks must be registered with the official Register of Legal Entities (webpage: www.registrucentras.lt). After registration, the Bank of Lithuania issues authorization, i.e. issues the bank a licence to provide licensed financial services (e.g. accepting deposits) if the following conditions are met: minimum capital (5 million EUR for commercial banks and special banks), and legal compliance on e.g. premises, shareholders and reliability of the general manager. The Law on Banks also contains special provisions for establishing banks, branches and representative offices of foreign banks and on the management of banks, for bank capital, operating risks, for the obligation to respect clients' interests, for supervision of groups of financial institutions on a consolidated basis, accounting, bank audits, banking supervision, closure and insolvency rules.

B. Accounts and Financial Transactions

I. Account

A bank account agreement defines the services to be provided by the bank and the payment obligations of the account holder. When concluding the agreement, the account holder must disclose all relevant personal details to the bank, including identification details. The Civil Code entails detailed provisions with regard to the rights and duties of the contracting parties. No restrictions are set with regard to the account type or the currency used. A bank deposit agreement must be in writing in order to be considered valid. Moreover, numerous regulations cover the bank deposit itself. If the bank deposit is not sufficient to meet all demands, claims will be satisfied according to the order set by law. Account information is in general covered by banking secrecy, which lasts indefinitely. Information covered by banking secrecy can be disclosed only in situations set by law to the client in person, upon the client's written instructions indicating to whom and what information should be disclosed, to state institutions to the extent this is in the bank's interest or under obligations arising out of the Law Against Money Laundering. In the case of a breach of bank secrecy, the bank will be held liable. The bank must also notify relevant information to the controlling authority in the fight against money laundering. The powers of the controlling authority are

regulated in the Law Against Money Laundering and in the Code of Criminal Procedure.

II. Financial Transactions

From 1 January 2015, Lithuania became a member of the euro area. The operation of the real-time payment system in euro are now executed in the system TARGET2-LIETUVOS BANKAS.

The most important provisions on financial transactions, including those with regard to the payment system, payment instruments and the legal relationship between the parties, can be found in the Law on Payments. Foreign currencies can only be used for cashless payments and if the parties consent. Cheques only play a minor role in financial transactions. There are no legal restrictions on financial transactions. However, in the case of a cash payment exceeding the sum of 15 000 EUR, the bank must inform the money laundering controlling authority. Security papers delivery and accounting systems are run by the Central Securities Depository. Through these systems, accounting on security transactions can be conducted in real time or to set times.

C. Credit and Security

I. Forms of Credit

The Civil Code sets regulations with regard to loans, bank credits as well as providing goods on credit and deferred payments. The institution of loan is understood as provision of funds to the ownership of another subject to the obligation to return the same sum plus interest. A credit agreement between a bank and a client must be in writing; if not, it is void.

The amount of interest for an amount on credit and the procedure for payment of interest is set by agreement between the parties. If the parties have not agreed on the amount of interest, then interest is calculated based on the average interest rate of commercial banks of the place of residence or business of the borrower which existed at the moment of execution of the credit agreement. If repayment is late, the bank may, except when otherwise stipulated, claim interest for delay at 5 % p.a., or 6 % p.a. in the case of traders. Unlimited loans

require 30 days' unilateral notice to terminate the loan agreement, if not agreed otherwise.

For consumer credit, i.e. the commercial grant of credit in any way, part payment clauses and leasing finance, additional formal disclosure requirements apply. The creditor must make disclosure to the debtor and must hand the debtor a written copy of the agreement. In case of noncompliance with the formal requirements, the debtor may terminate the agreement without payment of interest by written notification 30 days in advance. In the case of interest-free credit, the debtor may repay the credit at any time except where the credit agreement states otherwise. The creditor may end the agreement by giving at least two weeks' written notice if a delay of one month occurs in repayment of at least 10% of the credit sum or delay lasts for more than three months in succession. In the case of linked agreements, the debtor can refuse fulfilment of the credit agreement if there are objections with regard to the linked agreement in his favour.

Banks can conduct finance leasing. According to the statutory definition, a leasing agreement obliges the lessor to purchase a certain good determined by the lessee and to lease it to the lessee against payment for commercial usage on condition that property in the good will pass to the lessee after payment in full (unless agreed otherwise). These rules also apply when the lessor is the owner of the leased good. By law, anybody can be a lessee, while a lessor must be a bank or a similar commercial legal entity. Potential leasing goods can be any non-consumable items, except for land and natural resources.

II. Security

The most important form of security is the mortgage. The existence of a mortgage depends on the existence of a secured claim. Items that can be mortgaged include real estate objects, airplanes, ships and companies as well as movables when mortgaged together with the immovable.
Regulated types of mortgages include:

- ordinary (one item mortgaged to secure one claim);
- general (several items mortgaged at once);
- foreign (the beneficiary of the mortgage is not the owner of the mortgaged item);

- maximum sum (maximum sum of the claim is set in the mortgage bond);
- joint (a single mortgage of items belonging to several owners);
- conditional (mortgage conditional upon a particular circumstance);
- corporate (mortgage of a legal entity).

A mortgage is created by an agreement between the parties, certified by a public notary. Following a recent change of regulation, there is no specific strict form of mortgage bond. Currently, a mortgage bond simply needs to contain certain relevant data on e.g. the debtor, creditor, security, the owner (if not the debtor), obligation. The mortgage is valid between the parties from the moment the mortgage agreement is certified by the public notary. But the agreement is effective against third parties only after registration in the Central Mortgage Register, which is accessible to the public (www.hipotekosistaiga.lt).

A pledge can be established by handing over the pledged item to the pledgee or by registration as a non-possessory pledge. For registration, a notarially certified version of the pledge agreement must be filed with the Central Mortgage Register. The pledged item can be an existing item of movable property, future property or circulating volume of stocks. For the last of these, the lien dies out on sale and new volume stocks are automatically subject to the pledge at the time of purchase. Foreclosure occurs by agreement between the parties or by auction.

There are three different register systems. Inventory, property relations and general burdens are recorded with the Register of Real Property, which is public (http://www.registrucentras.lt/ntr/index_en.php). Mortgages and pledges are registered with the Central Mortgage Register. A third register has been established for registration of acts of seizure. These acts are registered with the Register of Property Seizure Acts. Mortgages, pledges (to the extent that they relate to real estate or companies) and seizure of real estate are, after registration with the Register of Property Seizure Acts, also notified to the Register of Real Property and registered there as well. Registration with the Central Mortgage Register is effective against third parties under the principle of public disclosure. Foreclosure on a

mortgage/pledge occurs through compulsory auction or forced administration.

Special regulations exist with regard to financial collateral. These regulations are laid down in the Law on Financial Collateral (Financial Collateral Law). This law applies to secured transactions among parties of a certain category, i.e. credit institutions, public entities and other subjects. Financial collateral comprises cash money and financial instruments. Two types of financial collateral arrangements are possible under the Financial Collateral Law: (i) security financial collateral arrangements and (ii) title transfer financial collateral arrangements.

Security financial collateral arrangements are in their nature very similar to pledge agreements, however, if security financial collateral arrangements fall under the scope of Financial Collateral Law, the special regime is applicable for such arrangements (for instance, they are protected in case of insolvency).

Financial collateral agreements and assignment of claim rights in case of default can also be used as security. The Civil Code regulates assignment of claim rights while regulations regarding financial collateral agreements are laid down in the Financial Collateral Law.

Another method to secure fulfilment of obligations is by way of surety. Suretyship is a contract by which the surety binds himself to be liable towards the creditor of another person gratuitously or for remuneration in the event where the person in whose favour suretyship is granted fails to perform the obligation in whole or in part. Suretyship may be established by contract, law or court order. It may secure existing as well as future obligations as long as they are precisely established. The surety contract must be in writing and may be between creditor and surety only or between creditor, debtor and surety. Noncompliance with the written form requirement makes the surety agreement ineffective. Once the creditor undertakes to foreclose on the debtor's obligation, the surety may instruct the creditor which of the debtor's property should be the object of the foreclosure, unless the contract states otherwise. Upon fulfilment of the obligations the surety steps into the creditor's shoes and is entitled to recover his expenses from the initial debtor. Surety contracts may have a fixed deadline, but may also

be tied to the term of the underlying obligation.

By a guarantee, the guarantor binds himself to guarantee fulfilment of the debtor's obligation. The guarantor is liable along with the debtor if no other arrangement has been made. In contrast, the guarantor of a common guarantee is subsidiarily liable. A common guarantee is not accessory and in case of non-compliance with the written form requirement it is held to be ineffective. By a bank guarantee, a credit institution undertakes the legal obligation to pay a certain sum to the creditor on demand. A bank guarantee must be in writing and must be irrevocable unless agreed otherwise. Moreover, it cannot be transferred.

Under the legal definition of a factoring agreement, the factor is obliged to pay a certain sum to their client in exchange for transfer of a claim. Assignment of accounts receivable (invoice discounting) can also be agreed. Only a bank or a factoring company holding a specific permit can be a factor. Factoring falls into the catalogue of financial services.

III. Foreclosure

For winding-up terminated credit agreements, Lithuanian banks in general follow a certain standardized procedure. The degree of standardization for consumer credits is higher than that of business credits, since these last can normally provide better security. Defaults, or credits conspicuous in some other way, are passed to a special division of the bank (e.g. Special Assets Department). After giving an unsuccessful warning, this department terminates the agreement. The subsequent winding-up phase normally involves the following measures: revaluation of credit security, restructuring of credit if continuation of the credit agreement appears profitable, realization of security, enforcement of claims, initiation of and participation in debtor insolvency and restructuring proceedings. A recent tendency with bigger business banks is to outsource these departments.
In Lithuania, claims from credit agreements expire after ten years.

The Law on Personal Bankruptcy was only recently adopted in Lithuania, As to insolvency of enterprises, two different laws are important: The Enterprise Bankruptcy Law and the Enterprise Restructuring Law (Restructuring

Law). The regulations of the Restructuring Law are often misused in order to gain time, since initiating insolvency proceeding is not possible as long restructuring is in progress. Courts often refuse to initiate insolvency proceedings because the insolvency estate is too little to cover the costs of the proceedings and the creditors are not willing to add the missing amounts to the insolvency estate. So in many cases there is no organized liquidation of insolvent companies. In insolvency proceedings, claims are satisfied according to their ranking position. Unsecured creditors' claims belong to the lowest ranking category, so that normally creditors do not recover any money. Credit claims should therefore be secured at an early stage.

D. Capital Markets Law

I. Securities Law

Admission and participation in securities trading and trading with financial instruments in the Lithuanian regulated market on the Vilnius Stock Exchange (http://www.lt.omxgroup.com) are all regulated by the Law on Markets in Financial Instruments. It also regulates supply of investment services, trading in regulated markets, prohibition of market abuse, posting of financial instruments and the Central Securities Depository, market supervision and liability for violations of the law. Credit institutions and other entities fulfilling certain criteria are eligible to be members of Vilnius Stock Exchange. Three lists of shares are traded on the stock exchange with different levels of licensing requirements. The lists also differ by type of security. Settlement is through the Central Securities Depository, which sets up and manages securities accounts. The Law on Securities (Securities Law) contains rules on public offers of securities, prospectuses, disclosure of information from issuers of securities, takeover rules, supervision of observance of the law and liability for violations. The financial services and markets supervision department of the Bank of Lithuania supervises securities trading as well as markets in financial instruments. An entity wishing to issue securities must draft a prospectus unless the issue qualifies as one of the exemptions to the obligation to publish a prospectus.

Foreign issuers have to meet higher requirements than domestic ones in order to be allowed to list their

securities in Lithuania. For issuers domiciled in EU Member States, prospectuses for securities must be certified by the regulating authority of the issuer's EU home State. Non-EU Member State issuers may also issue securities in Lithuania if they meet the applicable requirements that include drafting a prospectus compliant with IOSCO disclosure standards and disclosing information that matches that required by the Securities Law.

II. Investment Business

The legal basis for establishing entities conducting investment business in Lithuania is the Law on Collective Investment Undertakings. This regulates the activities of collective investment undertakings and management companies of collective investment undertakings as well as supervision of the two. Only an appropriately licensed entity can operate as a management company. Only a limited liability company can apply for a licence. A management company can manage investment funds and investment companies as well as supplying other services covered by its licence, for example, managing client portfolios, advising on investment in financial instruments. The law distinguishes between five different types of special collective investment undertakings: collective investment undertakings for investing in transferrable securities; real estate collective investment undertakings; private equity collective investment undertakings; collective investment undertakings investing in other collective investment undertakings; closed-ended type collective investment undertakings.

III. Pension Funds

A clear distinction exists between mandatory pensions and voluntary pensions. Pension funds for voluntary saving and investing money are treated and supervised as financial market participants. Activities of pension funds are regulated by the Law on Additional Voluntary Pension Accumulation. This specifically states that pension funds must hold a diversified investment portfolio. Voluntary pension funds are mutually owned by the individuals contributing to them and management is delegated to a pension fund management company. The investment strategies of each pension fund as well as other relevant issues are outlined in its own individual rules.

Contact

Estonia
bnt attorneys-at-law Advokaadibüroo OÜ
Tatari 6,
EE-10116 Tallinn
Phone: +372 667 62 40
Fax: +372 667 62 41
info.ee@bnt.eu

contact person:

Aet Bergmann

Latvia
bnt Klauberg Krauklis ZAB
Alberta iela 13
LV-1010 Riga
Phone: +371 6777 05 04
Fax: +371 6777 05 27
info.lv@bnt.eu

contact person:

Girts Osis

Theis Klauberg

Lithuania
bnt Heemann Klauberg Krauklis APB
Embassy House
Kalinausko 24, 4th floor
LT-03107 Vilnius
Phone: +370 5 212 16 27
Fax: +370 5 212 16 30
info.lt@bnt.eu

contact person:

Karolina Grityte

Frank Heemann

bnt
attorneys-at-law