LEGAL FRAMEWORK REGARDING THE EFFECTS OF BANKRUPTCY IN MEMBRANE FINANCE'S BUSINESS OPERATIONS

Date: 11.10.2023

The examination presented in this note is based on the legal sources described below, on the interpretation of an independent third-party expert ("expert") contracted by Membrane Finance Oy ("Membrane") and on the conversations with relevant authorities. In support of this note, the following laws and legal sources, among other materials, have been reviewed:

- Payment Institution Act of Finland (297/2010)
- Bankruptcy Act of Finland (120/2004)
- Enforcement Code of Finland (705/2007)
- Act on the Financial Stability Authority of Finland (1195/2014)
- EU Deposit Guarantee Scheme Directive 2014/49/EU
- Government Proposal HE 175/2014 of Finland
- Financial Stability Authority of Finland's website: https://rvv.fi/en/frontpage
- The Finnish Financial Supervisory Authority's (FIN-FSA) register of the supervised entities: https://www.finanssivalvonta.fi/en/registers/supervised-entities/

1. Are Membrane Finance's Customer Funds Safe in Case of Membrane Finance's Bankruptcy?

Membrane Finance is an electronic money institution (EMI) licensed in Finland by the FIN-FSA in November 2022. As an EMI, Membrane Finance has an obligation to safeguard customer funds in accordance with the relevant legislation. Section 26 of the Payment Institution Act of Finland (297/2010) regulates the safeguarding of customer funds by an EMI as follows (please note that the Act uses the words '*payment institution*' and '*electronic money institution*' partly as synonyms):

> *A payment institution shall hold the funds referred to in subsection 1 so that there is no danger of their commingling with the funds of another payment service user, payment service provider or payment institution. The payment institution shall deposit the funds in an account in the central bank, a deposit bank or in a credit institution authorised in another State and entitled to receive deposits or in low-risk and liquid securities or other investment targets if the funds have not been delivered to the payee or transferred to another payment service provider on the business day following the day of receipt of the funds. Funds which the service provider credits to an electronic money institution on the basis of the use of electronic money shall be deposited or invested in accordance with this subsection as soon as the funds are available to the electronic money institution, however, at the latest on the fifth business day following the issue of the electronic money. The Financial Supervisory Authority shall issue regulations on when a security or other investment target may be deemed low-risk and liquid.*
>
> *A payment institution may safeguard the funds referred to in subsection 1 also so that, in the event of insolvency of a payment institution, the funds received by the payment institution are paid to the payment*

> *service users from an insurance policy or guarantee from an insurance company or a credit institution which does not belong to the same group as the payment institution.*

In the context of Membrane Finance's possible bankruptcy, Section 26 of the Payment Institution Act of Finland (297/2010) has a connection to Chapter 5, Section 6 of the Bankruptcy Act of Finland (120/2004), which regulates the bankruptcy related to assets of third parties as follows:

> ***Assets in the possession of the debtor but belonging to a third party shall not be assets of the bankruptcy estate if they can be detached from the debtor's assets****. The assets of the third party shall be surrendered to the owner or to an assignee of the owner subject to such conditions that the bankruptcy estate is entitled to impose.*

Furthermore, Chapter 4, Section 9 of the Enforcement Code of Finland (705/2007) states that:

> ***Property belonging to a third party may not be attached****, unless in accordance with a ground for enforcement it stands as security for the applicant's receivable or it is a constituent part or appurtenance of an attached object belonging to the debtor*

Therefore, based on the relevant legislation, as a strong general rule the customer funds held by Membrane Finance shall be considered the property of third parties (customers) and not belong to the bankruptcy estate of Membrane Finance, whereby the customer funds shall be regarded to be safe in case of bankruptcy of Membrane Finance.

To be noted, the afore specified general rule requires that:

(i) the relevant agreement between Membrane Finance and the custodial bank used by Membrane Finance meets the legal requirements,
(ii) the customer funds are segregated from Membrane Finance's own funds, and
(iii) Membrane Finance and the custodial bank have acted in accordance with their legal requirements.

If the aforementioned practical prerequisites are not met, it could be determined that the customer funds have commingled with Membrane Finance's own funds, in which case they could belong to Membrane Finance's bankruptcy estate.
Since both Membrane Finance, as an EMI, and the custodial bank, as a credit institution, are both highly regulated and supervised entities, all of the parties' practices related to the safeguarding of customer funds should by default fulfill the regulatory requirements. Furthermore, it is extremely unlikely that Membrane Finance and/or the custodial bank would deliberately breach their regulatory obligations – such behavior could result in criminal proceedings. **Therefore, by default the customer funds shall be regarded to be safe in case of bankruptcy of Membrane Finance.**

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2. Are Membrane Finance's Customer Funds Safe in Case of Membrane Finance's Custodial Bank's Bankruptcy?

To be noted, Membrane Finance may use the services of custodial banks that are established in the European Economic Area (EEA). If Membrane Finance were to use the services of custodial banks established elsewhere than Finland, their operations would be governed by laws other than the laws of Finland.

As a Finland-based expert, we are able to address question 2 in light of Finnish legislation. Hence, below we interpret what would happen if Membrane Finance would use the services of a Finland-based custodial bank, and the Finland-based custodial bank would go bankrupt. However, since the Finnish legislation is largely based on EU-legislation, it is our presumption that most of the below interpretations could apply within the entire EEA-area. This being said, the actual legal stance of a given custodial bank would always be contingent on which jurisdiction the custodial bank operates in and which state's legislation applies to the custodial bank.

In referral to the afore in detail described Section 26 of the Payment Institution Act of Finland (297/2010), Chapter 5, Section 6 of the Bankruptcy Act of Finland (120/2004) and Chapter 9, Section 4 of the Enforcement Code of Finland (705/2007), as a strong general rule the customer funds held at a custodial bank shall be considered the property of third parties (customers) and not belong to the bankruptcy estate of the custodial bank, whereby customer funds shall be regarded to be safe in case of bankruptcy of the custodial bank.

To be noted, the general rule requires that:

(i) the relevant agreement between Membrane Finance and the custodial bank meets the legal requirements,

(ii) the customer funds are segregated from other funds (e.g. from Membrane Finance's and/or the bank's funds), and

(iii) the custodial bank has acted in accordance with its legal requirements.

If the aforementioned practical prerequisites are not met, it could be determined that the customer funds have commingled with other funds, in which case they could belong to the custodial bank's bankruptcy estate.
Since both Membrane Finance, as an EMI, and the custodial bank, as a credit institution, are both highly regulated and supervised entities, all of the parties' practices related to the safeguarding of customer funds should by default fulfill the regulatory requirements. Furthermore, it is extremely unlikely that Membrane Finance and/or the custodial bank would deliberately breach their regulatory obligations – such behavior could result in criminal proceedings. **Therefore, by default the customer funds shall be regarded to be safe in case of bankruptcy of the custodial bank.**

3. Should Customer Funds Held at Custodial Banks in Low-Risk and Liquid Securities or Other Investment Targets Be Given Special Consideration in Bankruptcy?

In referral to the afore in detail described Section 26 of the Payment Institution Act of Finland (297/2010), an EMI may hold customer funds at a custodial bank in (i) a custody account, or (ii) *low-risk and liquid securities or other investment targets* (Investment Instruments).

As is described in questions 1 and 2, the strong general rule is that the customer funds held at a custodial bank (including Investment Instruments) shall be considered the property of third parties (customers) and not belong to the bankruptcy of Membrane Finance or the custodial bank. Therefore, by default the Investment Instruments should not be in need of special consideration in a bankruptcy.

However, from a practical point of view, it is (at least in theory) possible that certain Investment Instruments could contain a higher risk of collusion than a regular bank deposit, as the Investment Instruments are in nature more versatile than a regular bank deposit. Hence, if Investment Instruments are used in the safeguarding of customer funds, it is recommended that only those Investment Instruments are used that do not contain a risk of commingled.

This being said, **as a strong general rule all customer funds held at a custodial bank in Investment Instruments shall be regarded to be safe in case of bankruptcy of Membrane Finance and/or the custodial bank.**

4. Does Deposit Guarantee Apply to Membrane Finance's Customer Funds?

The deposit guarantee schemes of EU member states have been harmonised. Deposit guarantees are governed by the EU Deposit Guarantee Scheme Directive, which includes harmonised provisions concerning rapid payment, depositors and deposits to be protected as well as the maximum compensation amount of EUR 100,000. Since Membrane Finance may only use EEA-based custodial banks, the customer funds accounts of Membrane Finance should always be covered by the deposit guarantee. For the absolute clarity, deposit guarantee only applies to deposits, and therefore, invested customer funds (see section 3) are not protected by the deposit guarantee in any case.

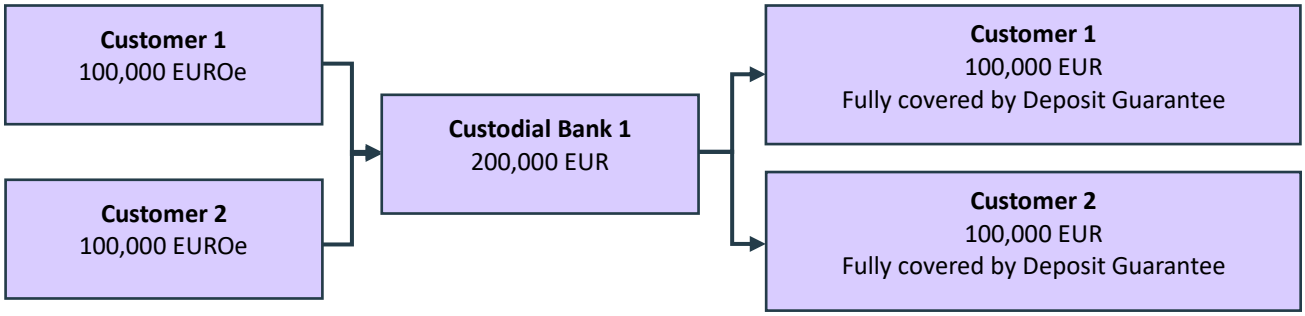
Given the harmonisation of the deposit guarantee schemes in the EU via the EU Deposit Guarantee Scheme Directive, the following rules of the Finnish legislation should be applicable across the EU in the member states' local legislation: according to (i) Chapter 1, Section 3, Subsection 1 Paragraph 15, (ii) Chapter 1, Section 3, Subsection 2 Paragraph 2 Subparagraph c and (iii) Chapter 5, Section 8 of the Act on the Financial Stability Authority of Finland (1195/2014), the customer of Membrane Finance is considered '*depositor'*, which refers to the party that is covered by the deposit guarantee. This approach is known as "**Pass-Through Approach**" according to which pooled custodian accounts are merely the aggregation of a number of smaller accounts, whereby each customer of an EMI benefits from the deposit guarantee up to the coverage limit, as the deposit guarantee is "passed through" to each individual account. Therefore, each of Membrane Finance's customer should be entitled to a maximum of EUR 100,000 (per used custodial bank) in case their funds would be lost due to a custodial bank's default.

To be noted, at the moment the potential varying implementation of the EU Deposit Guarantee Scheme Directive between the Member States could lead to differing interpretations. However, based on the information at our disposal, the EU is currently in the process of updating the EU Deposit Guarantee Scheme Directive to explicitly incorporate the Pass-Through Approach for uniform application across all EU Member States. Thus, in the near future, the Pass-Through Approach is expected to be the standardized practice across all EU Member States, eliminating any interpretational differences and ensuring uniform deposit guarantee coverage.

Commentary and a Practical Example Presented by Membrane Finance in Regard to Question 4

By the interpretation of Membrane Finance, the following examples illustrate how Deposit Guarantee applies to customer funds under various situations where none of the funds are invested:

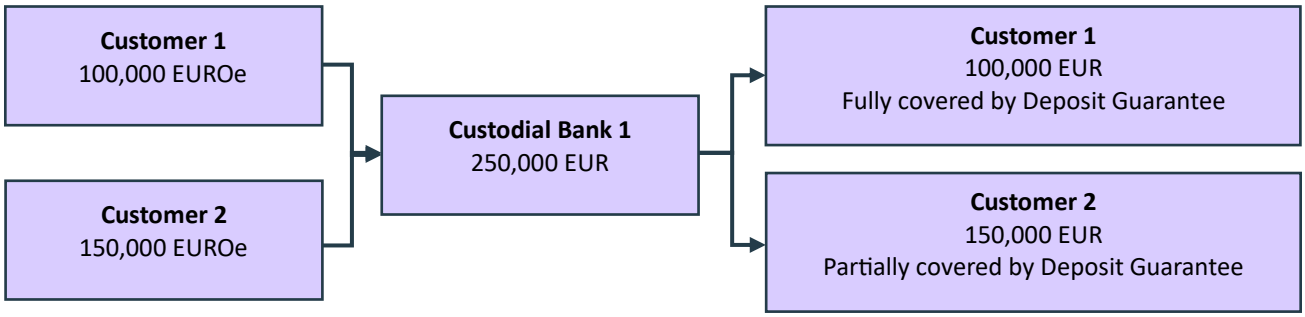
Situation 1: Two Customers Hold 100,000 EUROe and Membrane Finance Utilises a Single Custodial Bank



In the case of the bankruptcy of the Custodial Bank:

- Customer 1 would be fully covered by the Deposit Guarantee Scheme, and
- Customer 2 would be fully covered by the Deposit Guarantee Scheme.

Situation 2: Two Customers Hold 100,000 and 150,000 EUROe and Membrane Finance Utilises a Single Custodial Bank



In the case of the bankruptcy of the Custodial Bank:

- Customer 1 would be fully covered by the Deposit Guarantee Scheme, and
- Customer 2 would be partially covered by the Deposit Guarantee Scheme (a total of 50,000 EUR of Customer 2's deposits would not be covered).

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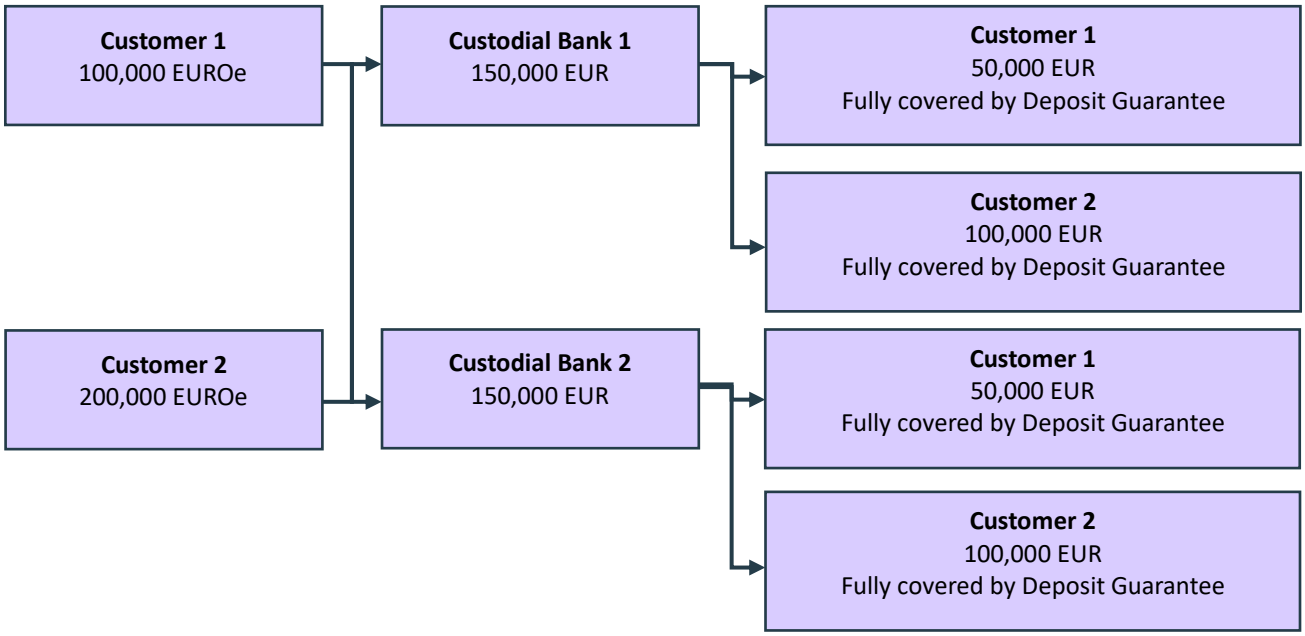
Situation 3: Two Customers Hold 100,000 and 200,000 EUROe and Membrane Finance Utilises a Two Custodial Bank Approach with Equal Amounts Held in Both Banks



In the case of the bankruptcy of both Custodial Banks:

- Customer 1 would be fully covered by the Deposit Guarantee Scheme, and
- Customer 2 would be fully covered by the Deposit Guarantee Scheme.

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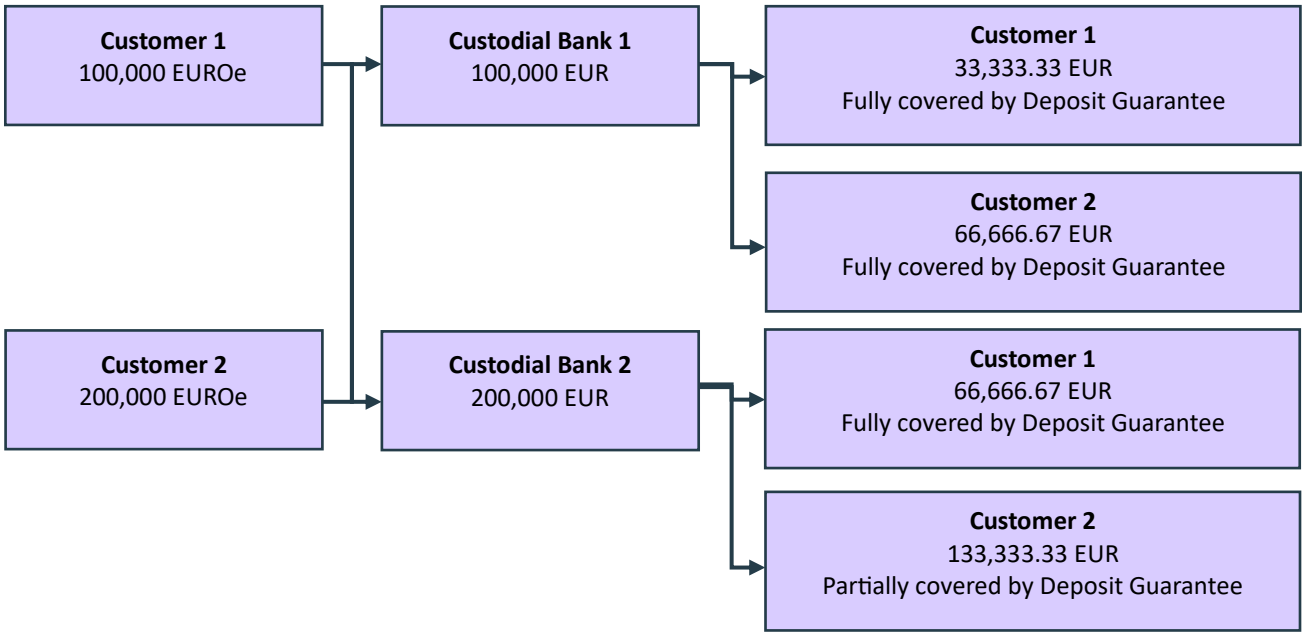
Situation 4: Two Customers Hold 100,000 and 200,000 EUROe and Membrane Finance Utilises a Two Custodial Bank Approach with Different Amounts Held in Both Banks



In the case of the bankruptcy of both Custodial Banks:

- Customer 1 would be fully covered by the Deposit Guarantee Scheme, and
- Customer 2 would be partially covered by the Deposit Guarantee Scheme (a total of 33,333.33 EUR of Customer 2's deposits would not be covered).