Introduction to Investments and Ribbis

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Question: There are many different types of investments in the business world today, and the halachos of *ribbis* (forbidden interest) vary depending upon which investment one engages. Can you give us a basic introduction to the various investments and how the halachos of *ribbis* apply to them generally?

Answer: There are indeed many different categories of investments, each of which raises a different *shaila* within the laws of *ribbis.* Investments in the business world today usually take the form of one of four different tiers of capital called the capital stack.

Capital Stack:

1. Common Equity- This refers to the owners or shareholders of the business. They have the most risk and most reward.
2. Preferred Equity- This is a situation where an investor gets paid from PROFITS before the other stakeholders. However, they do not count as a "loan" on the books, and they cannot collect assets and the like if the venture fails.
3. Mezzanine Debt- This is debt that can be **converted** into equity, such as a convertible note.
4. Senior Debt/ Bank Debt- This is a pure loan, where if the investment fails, they can collect from other assets.

Example: One is creating a business, and needs one million dollars of investment. He puts in $100,000 dollars of his own money (common equity/owner), and risks either losing all of it or receiving all of the profit himself. As he cannot cover the full investment himself, he often will also attempt to receive a large investment, let's say $700,000 from the bank, known as a "senior debt" or "bank debt." This would be classified as a regular loan or *chov* (debt) as the bank requires that the entire sum be returned at a later point and is classified as the fourth tier on the other extreme, as they are taking virtually no risk.

As he needs $200,000 dollars more, he will now need other private investors or venture capitalists. This is often done in one of two ways. The first is known as preferred equity, which has some protections or guarantees in it. In this type of investment, investors take precedence over the other common equity stakeholders in getting paid from the profits if the project goes well. While this is not technically a "loan" there can be *ribbis* issues.

The second of the middle categories is known as convertible notes, or mezzanine debts, which start off as **debt**, but can eventually turn into **equity**, and potentially creates more complicated halachic *shailos*.

In the case of preferred equity, there are times when the investment (on the part of a Jew) may constitute *ribbis deoraisa*, times when it may be *ribbis derabanan*, and sometimes where it is a *heter gamur* (entirely permitted). The most important thing to know when asking a *shaila* about such investments is the precise details of the entire investment that one has. As many times, one will only mention certain pieces of the deal, not realizing that the other components of the deal may be problematic.

Within this context, it is important to note that although *ribbis deoraisa* and *ribbis derabanan* are both *assur,* there are nevertheless *nafka minas* (practical differences) between them, which is why it is important to properly classify the type of loan and the level of *ribbis* involved. In cases of *ribbis deoraisa,* one must be *machmir* concerning a non observant Jew, if we are not sure whether he is a *mumar* (a Jew who intentionally violates the rules of the Torah) or *tinok shenishba* (non observant Jews who are unfamiliar with the halacha), while in cases of *ribbis derabanan,* there may be room to be *makeil* if necessary.

In any case, it is worthwhile to have a *posek* examine the entire *shtar* to evaluate the status and then determine whether the investment can be undertaken in a permitted manner.

Question: What determines whether the loan is permitted or not on a basic level?

Answer: If you are buying a stake and your money is at **risk**, that is the first step towards ensuring that the investment is not considered *ribbis,* as it would not qualify as a loan concept, in which your return is **guaranteed**. If there is little to no risk involved and your investment has a lot of guarantees or protections, then you may be violating the laws of *ribbis* on some level.