

THE LENDING
AND SECURED
FINANCE REVIEW

FOURTH EDITION

Editor
Azadeh Nassiri

THE LAWREVIEWS

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AND SECURED
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This article was first published in August 2018
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Published in the United Kingdom

by Law Business Research Ltd, London

87 Lancaster Road, London, W11 1QQ, UK

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www.TheLawReviews.co.uk

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Enquiries concerning reproduction should be sent to Law Business Research, at the address above.

Enquiries concerning editorial content should be directed
to the Publisher – tom.barnes@lbresearch.com

ISBN 978-1-912228-44-7

Printed in Great Britain by

Encompass Print Solutions, Derbyshire

Tel: 0844 2480 112

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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ADVOKATFIRMAET BAHR AS

ALLEN & OVERY

ALTIUS

ALUKO & OYEBODE

ANJIE LAW FIRM

BONELLIEREDE

BREDIN PRAT

CYRIL AMARCHAND MANGALDAS

DE BRAUW BLACKSTONE WESTBROEK

GOODMANS LLP

HAMILTON ADVOKATBYRÅ

HENGELER MUELLER, PARTNERSCHAFT VON RECHTSAWALTEN MBB

LEE AND LI, ATTORNEYS-AT-LAW

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MORI HAMADA & MATSUMOTO

PAKSOY

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

PINHEIRO NETO ADVOGADOS

RAHAYU & PARTNERS IN ASSOCIATION WITH HFW

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URÍA MENÉNDEZ ABOGADOS, SLP

VIEIRA DE ALMEIDA

WOLF THEISS

CONTENTS

PREFACE.....	vii
<i>Azadeh Nassiri</i>	
Chapter 1	AUSTRIA..... 1
<i>Leopold Höber</i>	
Chapter 2	BELGIUM 12
<i>Yves Brosens and Britt Vanderschrick</i>	
Chapter 3	BRAZIL..... 22
<i>Bruno Balduccini and Roberto Panucci Filho</i>	
Chapter 4	CANADA..... 34
<i>Jean E Anderson, David Wiseman, David Nadler, Carrie B E Smit, Caroline Descours and Cathy Costa-Faria</i>	
Chapter 5	CHINA..... 50
<i>Gulong Ren</i>	
Chapter 6	ENGLAND & WALES..... 61
<i>Azadeh Nassiri and Kathrine Meloni</i>	
Chapter 7	FRANCE..... 78
<i>Karine Sultan, Yves Rutschmann, Charlotte Bonsch, Béna Mara and Victoire de Ménonville</i>	
Chapter 8	GERMANY..... 92
<i>Christian Schmies, Nikolaus Vieten and Jens Wenzel</i>	
Chapter 9	HONG KONG 102
<i>Peter Lake</i>	

Contents

Chapter 10	INDIA	115
	<i>L Viswanathan and Dhananjay Kumar</i>	
Chapter 11	INDONESIA.....	133
	<i>Sri H Rahayu, Indra Prawina and Indriana Pramesti</i>	
Chapter 12	IRELAND	146
	<i>John Breslin and David Burke</i>	
Chapter 13	ITALY	154
	<i>Giuseppe Sacchi Lodispoto and Raffaella Riccardi</i>	
Chapter 14	JAPAN	167
	<i>Hiroki Aoyama and Keigo Kubo</i>	
Chapter 15	LUXEMBOURG.....	176
	<i>Henri Wagner and François-Guillaume de Liedekerke</i>	
Chapter 16	NETHERLANDS.....	194
	<i>Menno Stoffer and Pieter Hooghoudt</i>	
Chapter 17	NIGERIA.....	204
	<i>Kofo Dosekun, Oludare Senbore and Oluwabukola Fadahunsi</i>	
Chapter 18	NORWAY.....	215
	<i>Audun Nedrelid and Markus Nilssen</i>	
Chapter 19	PORTUGAL.....	223
	<i>Pedro Cassiano Santos and Ricardo Seabra Moura</i>	
Chapter 20	SPAIN.....	235
	<i>Ángel Pérez López, Pedro Ravina Martín and Blanca Arlabán Gabeiras</i>	
Chapter 21	SWEDEN.....	248
	<i>Eric Halvarsson and Fredrik Gillgren</i>	
Chapter 22	SWITZERLAND	257
	<i>Patrick Hünerwadel, David Ledermann and Marcel Tranchet</i>	
Chapter 23	TAIWAN.....	266
	<i>Abe Sung and Mark Yu</i>	

Contents

Chapter 24	TURKEY.....	274
	<i>Sera Somay</i>	
Chapter 25	UNITED STATES.....	288
	<i>Monica K Thurmond</i>	
Appendix 1	ABOUT THE AUTHORS.....	299
Appendix 2	CONTRIBUTING LAW FIRMS' CONTACT DETAILS.....	317

PREFACE

This fourth edition of *The Lending and Secured Finance Review* contains contributions from leading practitioners in 25 different countries, and I would like to thank each of the contributors for taking the time to share their expertise on the developments in the corporate lending and secured finance markets in their respective jurisdictions and on the challenges and opportunities facing market participants. I would also like to thank our publishers without whom this review would not have been possible.

I hope that the commentary that follows will serve as a useful source for practitioners and other readers.

Azadeh Nassiri

Slaughter and May

London

July 2018

HONG KONG

*Peter Lake*¹

I OVERVIEW

While syndicated loan volumes continued their decline by hitting a five-year low in the Asia Pacific (ex Japan) market, Hong Kong loan volumes continued to increase to hit a new record of US\$111.5 billion in 2017. This surpassed last year's record setting US\$106 billion by 5 per cent. Hong Kong and China continued their dominance of the Asia-Pacific (excluding Japan) syndicated loan market and accounted for 49 per cent of lending during this period.²

One of the more significant Hong Kong loan transactions of 2017 was a US\$3.6 billion term loan for the privatisation of Hong Kong-listed shoe retailer Belle International Holdings Limited involving a sole underwriter and 10 lenders. The year also saw large loans for Chinese companies including technology and e-commerce firms such as Alibaba Group and its affiliate Ant Financial Services Group, Tencent Holdings Limited and JD.com.³ The active Hong Kong real estate market is set to contribute to the loan volume in 2018 as buyers seek finance for their purchases. This includes a US\$2.1 billion senior bridge loan to finance the acquisition by a Chinese consortium of The Center, Hong Kong's fifth-tallest building, in the city's most expensive commercial real estate deal.⁴

Hong Kong has an active bilateral loan market.

Syndicated lending is generally documented using the facility agreement forms prepared by the Asia Pacific Loan Market Association.

The main providers of finance are the Hong Kong-regulated financial institutions that have been authorised under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) as 'authorized institutions' to hold banking licences. Funds and private equity houses are more visible in bilateral bridge or other short-term bespoke financing arrangements.

II LEGAL AND REGULATORY DEVELOPMENTS

i Companies Ordinance

On 3 March 2014, a restatement of the Companies Ordinance (Chapter 622 of the Laws of Hong Kong) was brought into effect. Of particular note to lenders are the following changes:

1 Peter Lake is a partner at Slaughter and May. The author would like to thank his colleagues Kevin Tso and Sophie Madden for their assistance in preparing the Hong Kong chapter.

2 Asia-Pacific loans continue slide to five-year low, published by Thomson Reuters on 29 December 2017.

3 Ibid.

4 Loan to Acquire Hong Kong's Most Expensive Office Tower Gets Costlier, published by Bloomberg on 15 March 2018.

- a* A reduction of the time period to register charges with the Companies Registry. The time period was reduced from five weeks to one month. The list of registrable charges was also amended and the underlying instrument of charge is now publicly available.
- b* Financial assistance no longer results in underlying transactions becoming voidable (although it remains a criminal offence for the companies giving financial assistance). The exemptions from financial assistance have been broadened.
- c* There have been changes to the terminology for financial statements.
- d* The abolition of the concepts of nominal share capital and premium, and of authorised share capital.
- e* The retirement of the memorandum of association.
- f* There is an additional procedure for Hong Kong-incorporated companies to execute documents by way of deed but without affixing the common seal.

Lenders have expressed concern with respect to the clarification under the Companies Ordinance that charges over bank accounts are not charges over book debts (and so are not registrable under that head of registration). Lenders receiving security over bank accounts wish to protect their position by ensuring the bank account charge is registered at Companies Registry. In light of the fact that bank account charges are not registrable *per se*, the usual technique to register a bank account charge is to notify the Companies Registry that the bank account charge may be construed as a floating charge (as all floating charges are registrable under a separate head of registration).

With underlying instruments of charge now publicly available, the Companies Registry has stated it is now ‘more important than ever’ for lenders to make enquiries and search the Companies Register for charges. Although there is no Hong Kong case law on this point, the availability of the underlying instrument of charge will likely impact upon the issue of priorities between competing charge instruments.

ii Foreign Account Tax Compliance Act

Hong Kong has implemented a Foreign Account Tax Compliance Act (FATCA) Model 2 intergovernmental agreement. Although there remains variance in terms, as far as borrower risk is concerned, the market has moved towards a balanced position.

iii Basel III – capital adequacy and capital buffer

Capital adequacy ratio

The Hong Kong Monetary Authority (HKMA) has issued rules under the Banking Ordinance (the Banking (Capital) Rules) (Chapter 155L of the Laws of Hong Kong) that prescribe in detail how the capital adequacy of locally incorporated authorised institutions should be calculated. These rules are based on the Basel III recommendations (which were implemented in Hong Kong on 1 January 2013).

A Hong Kong-incorporated authorised institution is required under the Banking (Capital) Rules to maintain a Common Equity Tier 1 (CET1) capital ratio of at least 4.5 per cent, a Tier 1 capital ratio of at least 6 per cent and a total capital ratio of 8 per cent. Branches of foreign banks are not subject to this requirement but, based on the HKMA’s past practice of generally requiring any foreign bank that wishes to establish a branch in Hong Kong to maintain a capital adequacy ratio of at least 8 per cent, it is likely that the HKMA will continue to require foreign banks to meet the three minimum risk-weighted capital ratios.

Capital buffers

In accordance with the Basel III recommendations, the HKMA may require an authorised institution to have further capital buffers to cater for risks and uncertainties that are not already captured by the three minimum risk-weighted capital ratios that comprise the 'capital adequacy ratio' described above. The HKMA has implemented the following capital buffers: the capital conservation buffer, the countercyclical capital buffer and (for domestic systemically important banks) the higher loss absorbency requirement.

The capital conservation buffer is being phased in equal annual increments. The capital conservation buffer is 1.875 per cent for 2018 and will increase to its upper level, 2.5 per cent, in 2019.

The level of the countercyclical capital buffer is determined by the HKMA's analysis on whether there is excess aggregate credit growth associated with a build-up of system-wide risk in Hong Kong. On 10 January 2018, the HKMA announced that the countercyclical capital buffer will increase from the current 1.875 per cent to 2.5 per cent with effect from 1 January 2019. This is in accordance with the Basel III phase-in arrangement, which is to be fully effective as of 1 January 2019 and sets a final maximum of 2.5 per cent for 2019. The HKMA regard a continued build-up of the buffer as appropriate given the risks associated with recent credit and property market conditions and external political uncertainties.

The higher loss absorbency requirement applies only to domestic systemically important banks (D-SIBs). It is an extension of the capital conservation buffer. On 29 December 2017, the HKMA announced that Hong Kong's list of D-SIBs has enlarged to cover six banks. The six D-SIBs are: The Hongkong and Shanghai Banking Corporation Limited, Bank of China (Hong Kong) Limited, Hang Seng Bank Limited, Standard Chartered Bank (Hong Kong) Limited, The Bank of East Asia, Limited and Industrial and Commercial Bank of China (Asia) Limited.

iv Sanctions and anti-corruption

Hong Kong banks must comply with the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Chapter 615 of the Laws of Hong Kong), which in particular sets out specific customer due diligence and record-keeping requirements that must be followed. In March 2015, the HKMA issued the guidance paper 'Anti-Money Laundering Controls over Tax Evasion'. The guidance paper is in addition to the HKMA's 'Guideline on Anti-Money Laundering and Counter-Terrorist Financing (for Authorized Institutions)', which was modified in March 2018 to reflect enhancements made in the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018. Both the guidance paper and the Guideline assist authorised institutions in complying with the Anti-Money Laundering and Counter-Terrorist Financing Ordinance.

Hong Kong-authorised institutions are required to check and report against the list of names issued under the US President's Executive Order 13224 and the list of names published under Hong Kong's United Nations (Anti-Terrorism Measures) Ordinance (Chapter 575 of the Laws of Hong Kong) (which is updated to reflect changes to the list of specified terrorists and terrorist associations designated by the United Nations Security Council).

Hong Kong has a separate enforcement agency, the Independent Commission Against Corruption (ICAC), to counter corruption. Its main focus is on preventing bribery (in both the public and private sectors).

v Benchmarks

Hong Kong Interbank Offered Rates (HIBOR) are available for borrowings in Hong Kong dollars and yuan (although the majority of offshore yuan-denominated loans do not use the HIBOR rates in respect of interest calculations). The HKMA issued a statutory guideline ‘Code of Conduct for Benchmark Submitters’, which came into effect on 3 May 2013. The guideline forms part of the HKMA’s Supervisory Policy Manual.

vi Banking resolution

EU Bank Recovery and Resolution Directive

With the implementation of Article 55 of the EU Bank Recovery and Resolution Directive (2014/59/EU), EU-based lenders typically require loan facilities that are governed by Hong Kong law to include contractual recognition of bail-in – whereby non-EU entities acknowledge that the EU lender may be subject to bail-in powers under that EU directive. The relevant language is usually based on the bail-in template language prepared by the Loan Market Association.

Hong Kong Financial Institutions (Resolution) Ordinance

Hong Kong’s Financial Institutions (Resolution) Ordinance (Chapter 628 of the Laws of Hong Kong) came into force on 7 July 2017 and is designed to meet international standards set by the Financial Stability Board. In due course, it is likely that contractual recognition of bail-in for non-Hong Kong law contracts will be required. The market language will no doubt closely follow the Loan Market Association’s bail-in template language. On 7 July 2017, the HKMA issued three Codes of Practice: ‘Resolution Planning: Core Information Requirements’ (CI-1), ‘Operational Independence of the Monetary Authority as Resolution Authority’ (RA-1) and ‘The HKMA’s Approach to Resolution Planning’ (RA-2).

vii Insolvency regime

Hong Kong’s insolvency regime remains creditor-friendly with no specific debtor resolution regime in place.

Amendments to the Companies (Winding Up and Miscellaneous Provisions) Ordinance 2016 (Chapter 32 of the Laws of Hong Kong) came into force on 13 February 2017. The amendments seek to enhance creditor protection, streamline the winding-up process and strengthen regulation under the winding-up regime.

The amendments introduce new provisions to empower the court, upon the application of the liquidator, to set aside ‘transactions at an undervalue’⁵ entered into within five years before commencement of the winding-up. The amendments also clarify existing provisions relating to transactions that are ‘unfair preferences’ entered into within six months (or, for a person connected to the company, two years) before the winding-up. For both provisions,

5 The meaning of ‘transaction at an undervalue’ is defined in the new Section 265E. A company enters into a transaction with a person at an undervalue if (1) the company makes a gift to that person, or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration; or (2) the company enters into a transaction with that person for a consideration the value of which, in money or money’s worth, is significantly less than the value, in money or money’s worth, of the consideration provided by the company.

in order for them to apply, the court must be satisfied that the company is unable to pay its debts at the time such transaction is made, or the company becomes unable to pay its debt as a consequence of such transaction.

When setting aside such transactions, the court may make an order as it thinks fit to restore the position to what it would have been had the company not entered into these transactions.

III TAX CONSIDERATIONS

The Hong Kong tax regime includes three separate types of income tax – property tax, salaries tax and profits tax. Of the three types of income tax, profits tax is most relevant to lenders.

Hong Kong does not have a separate capital gains tax regime.

i Profits tax

Hong Kong adopts a territorial source principle of taxation.

Under the Inland Revenue Ordinance (IRO) (Chapter 112 of the Laws of Hong Kong), profits tax is charged on a person carrying on a trade, profession or business in Hong Kong; and in respect of income profits (excluding capital gains profits) arising in or derived from Hong Kong from that trade, profession or business.

The rate of profits tax for corporations is 8.25 per cent on profits up to HK\$2 million and 16.5 per cent on the remainder for the year of assessment commencing 1 April 2018.

Carrying on a trade, profession or business in Hong Kong

A low threshold is required to fall within the scope of carrying on a trade, profession or business in Hong Kong. The activity of depositing may, for example, be sufficient to constitute a business.

Income arising in or derived from Hong Kong

If the above test – of carrying on a trade, profession or business in Hong Kong – is satisfied, then profits tax will (subject to exemptions) be chargeable if the income arises in or is derived from Hong Kong.

This is a factual issue, which is determined by looking at what the taxpayer has done to earn the relevant profit. A test often applied in difficult cases is where the operations take place from which the profits in substance arise. The place where a taxpayer's profits arise is not necessarily the place where he or she carries on business.

Inland Revenue Department guidelines and case law assist in determining the locality where income arises, or where it is derived from.

Because of the difficulties in assessing the locality of interest and related fee income received by financial institutions, the Inland Revenue Department issued Departmental Interpretation and Practice Notes No. 21: Locality of Profits (revised July 2012), setting out the Inland Revenue Department's current practice. A modified extract from the practice note on the tax treatment of interest from loans is set out below.

Types of interest income from loans	Tax treatment
<i>Offshore loans initiated, negotiated, approved and documented by an associated party outside Hong Kong and funded outside Hong Kong (i.e., funds raised and loaned direct to the borrower by a non-resident; for example, head office, branch, or subsidiary, etc.) albeit through or in the name of the Hong Kong institution.</i>	100 per cent non-taxable
<i>Offshore loans initiated, etc., by the Hong Kong institution and funded by it in or from Hong Kong.</i>	100 per cent taxable
<i>Offshore loans initiated, among others, by an associated party outside Hong Kong but funded by the Hong Kong institution.</i>	50 per cent taxable
<i>Offshore loans initiated, etc., by a Hong Kong institution but funded by offshore associates. It is considered that this category only applies to start-up positions where the Hong Kong institution has yet to establish a market presence.</i>	50 per cent taxable

Note on 'funding'.

For claims concerning loans funded by offshore associates, two essential requirements will have to be satisfied, namely:

- a that the Hong Kong institution does not have the authority to seek its own source of funds in respect of the loans; and*
- b there must be documentary evidence to show that funds have been directly provided by an offshore associate even though such funds may have been routed through another vehicle in Hong Kong. In other words, arbitrary funding by another group vehicle in Hong Kong will not satisfy this requirement.*

Note on 'initiation'.

'Initiation' refers to the efforts exerted in obtaining the particular business including solicitation, negotiation and structuring of the loans. The financial institution must be able to substantiate that the mandate or invitation to participate was secured as a direct result of the activities of an associated party outside Hong Kong for an offshore claim to succeed.

Participation, commitment and other fees will follow the tax treatment accorded to the related loan under the above.

Deductibility of interest paid by borrowers

Payments of interest by a Hong Kong corporate that are incurred in the production of its chargeable profits are generally deductible, subject to certain anti-avoidance provisions. The anti-avoidance provisions seek to deal with the lack of symmetry in tax treatment on interest received (as the starting point is that interest income is not taxable, while interest expenses are tax-deductible).

ii Double taxation agreements

As of 2 May 2018, Hong Kong had comprehensive double taxation agreements with Austria, Belarus, Belgium, Brunei, Canada, the Czech Republic, France, Guernsey, Hungary, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, China, Portugal, Qatar, Romania, Russia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.

A comprehensive double taxation agreement has been signed but is not yet in effect with Saudi Arabia.

The terms set out in double taxation agreements take precedence over the other provisions of the IRO.

iii Stamp duty

Hong Kong stamp duty is chargeable on certain transactions (including the issue of certain bearer instruments) but is not chargeable on the entering into or transfer of loan facility agreements (on the basis that a transfer under a loan facility typically will not require registration in a register located in Hong Kong).

Lenders may therefore transfer their commitments and loans either by way of assignment or novation.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Common methods of taking security in Hong Kong include:

a Mortgage:

- Mortgages involve the mortgagor transferring the property to the mortgagee, with the mortgagor having an equitable right to have the property returned upon paying off the debts to which the mortgage relates. Although it may be used for a variety of types of property, it is more commonly used for real property. The Conveyancing and Property Ordinance (Chapter 219 of the Laws of Hong Kong) sets up a statutory overlay in respect of Hong Kong real property, so that any mortgage of a legal estate in Hong Kong real property may only be effected at law by a deed expressed to be a legal charge (which type of charge is a creature of statute).

b Charge or assignment by way of security:

- Hong Kong recognises both fixed and floating charges, with fixed charges taking priority over floating charges where the chargee has had no notice of negative pledge prohibitions. Charges may be granted over future property.
- Charges over choses in action are usually drafted as an assignment by way of security – although the courts make little distinction between (1) charges and (2) assignments by way of security.

c Pledge (by way of transfer of possession of tangible property).

d Lien (by way of the lienholder retaining possession of tangible property).

The typical ways of taking security over real estate; tangible movable property; shares and financial instruments; contractual rights and receivables; and intellectual property rights are described below.

Real estate

Security over Hong Kong real estate is often given by way of fixed legal charge (whereas security over choses in action related to the property is given by way of assignment). Although lenders are not required to adopt any specific mortgage form, the Hong Kong Mortgage Corporation Limited has introduced a set of standard form model mortgage documents in respect of residential properties.

Security granted over a registrable interest in land must be registered with the Land Registry.

Tangible movable property

Security over tangible movable property is often given by way of fixed or floating charge:

- a* Fixed charge: a fixed charge is created over a particular identified property (which may include future property). The chargee's consent is required for the chargor to dispose of the property free from the charge. If the chargor defaults, the chargee may enforce the charge by selling the property. Typically, the chargee will appoint a third-party receiver to enforce the charge, in order to protect the chargee from potential liability arising from enforcement.
- b* Floating charge: a floating charge is similar to a fixed charge but is created over a moving class of assets (such as stock), which may change from time to time. Unlike a fixed charge, the chargor may dispose of the charged assets and carry on its business as usual until an event (such as acceleration under an event of default) occurs that crystallises the floating charge into a fixed charge. Floating charges rank behind fixed charges granted (before floating charge crystallisation) over the same property.

To reduce the risk of tangible charged property being sold to a *bona fide* purchaser of the legal estate without notice of the charge, where possible, plaques should be attached to the charged property to give notice to third parties of the existence of the charge.

Shares and financial instruments

Security over shares and financial instruments is often given by way of fixed or floating charge.

The charging language used will depend upon whether the shares are held directly in certificated form or held indirectly via a nominee or custodian.

In the case of a charge over Hong Kong shares held directly in certificated form, the chargor will transfer the share certificate to the chargee and execute a blank form of instrument of transfer and a blank sale contract note, which the chargee may complete upon enforcement and use to transfer the shares to a third party. The chargee may also ask the chargor to arrange for the signature – by the directors of the underlying company whose shares are charged – of certain undated board resolutions and undated resignation letters of directors, with authority for the chargee to complete these documents upon enforcement.

Unless the share charge extends to a charge over dividends, notice is typically not sent to the company whose shares are charged as this will not affect priorities (Section 634 of the Companies Ordinance states that no notice of trust may be entered in a Hong Kong company's register of members). This means that, under a share charge, a chargee is exposed to the risk of a chargor transferring legal title to the charged shares to a *bona fide* purchaser without notice. Such a *bona fide* purchaser without notice would likely take the shares free of the charge. It should be noted that although the chargee holds the share certificate, the chargor may apply to the company for a new share certificate on the basis that the previous share certificate has been lost or destroyed. Although there is a court process under which a 'stop notice' may be served by the chargee on the underlying company whose shares are charged, requiring the underlying company to give notice to the chargee if the chargor attempts to transfer the shares, this process is rarely used.

When taking security over shares and financial instruments, the terms governing the underlying shares or instrument must be checked to ensure there are no provisions prohibiting transfer (and, if there are, those provisions should be amended).

In the case of a charge over shares held indirectly via a nominee or custodian, the charging language is more similar to that used for contractual rights and receivables (described below). Notice of the share charge should be sent to the nominee or custodian to preserve priority.

For other financial instruments, notice of a charge should usually be given to preserve priority (with the notice given to the person who either owns the instrument on behalf of the chargor, or to the payor under the instrument, as applicable).

Contractual rights and receivables

Security over contractual rights and receivables is usually drafted in the form of an assignment by way of security. Courts make little distinction between a fixed charge and an assignment by way of security.

As for shares and other instruments, the terms of the contractual rights and receivables should be reviewed to ensure there are no provisions prohibiting transfer (and, if there are, those provisions should be amended).

Notice of charge should be given to the debtor or payor to which the contractual rights and receivables relate in order to preserve priority.

Intellectual property rights

Hong Kong has specific registries for patents, trademarks and designs, although there is no registry for copyright.

Security is usually taken in the form of a mortgage, or charge or assignment, by way of security.

Security over registered intellectual property should be registered at the Hong Kong Patents Registry, the Trade Marks Registry or the Designs Registry. If the security is not registered, it is ineffective against certain acquirers who acquire the intellectual property without notice of the security. There is no legal requirement to make the registrations within a specified time, although late registration may impact upon damages claims as well as priority and perfection against third parties.

Formalities

Hong Kong real estate – Land Registry

Security over Hong Kong real estate (if registrable) must be registered with the Land Registry to protect its priority. If the document is registered within one month of execution, it takes priority from the date of execution. Late registrations will take priority from the date of registration.

Companies Registry

Where the grantor is (1) a Hong Kong-incorporated company; or (2) a non-Hong Kong company that is registered at the Companies Registry (usually required by reason of having a place of business in Hong Kong) that is granting security over Hong Kong property, then specified types of security must be registered with the Companies Registry within one month of execution. Otherwise, the security will be void against any creditor or liquidator and the chargor company (and certain of its officers) will commit an offence.

The more common types of security that must be registered include:

- a* security over any property where the security granted is a floating charge;
- b* security over chattels;
- c* security over land;
- d* security over book debts (but excluding bank accounts);
- e* security over ships;
- f* security over aircraft; and
- g* security over goodwill, patents, trademarks and copyright.

The full list of securities that must be registered is set out in Section 334 of the Companies Ordinance.

Note that although security over a bank account is not registrable as book debts, it will be registrable if the security is a floating charge. The question of characterisation of security is both a matter of form and substance. A factor to take into account will be the nature of the dealings and interactions between the chargor and chargee.

Registration requirements also apply where an asset is acquired that is subject to security.

IP registers

Security over patents, registered designs and trademarks are subject to specific registrations:

- a* security over patents and registered designs must be recorded at the Hong Kong Patents Registry by filing Form P19 or the Designs Registry by filing Form D5; and
- b* security over a registered trademark must be registered with the Trade Marks Registry by filing Form T10.

An unregistered security interest over a registered patent, design or trademark is ineffective against certain acquirers who did not have notice of the security interest at the time of acquisition.

Aircraft

Although there is no statutory duty to do so, market practice is to notify the Civil Aviation Department in Hong Kong of the security interest, and to include chargee details on the nameplate of the aircraft, in order to give notice of the security interest to third parties.

Ships

Security over ships is usually by way of mortgage. A mortgage over a Hong Kong-registered ship must be in a prescribed form and registered with the Hong Kong Shipping Registry. Priority is accorded from the time of registration.

ii Guarantees and other forms of credit support

Guarantees are commonly used in Hong Kong as a form of credit enhancement. Market documentation prepared by the Asia Pacific Loan Market Association includes loan facility agreements with integrated guarantee provisions.

Other credit support techniques that may be used include sale and leasebacks, transfer of collateral with an obligation to return the same (or equivalent) collateral, disposal of receivables with recourse remaining against the transferor, retention of title arrangements and contractual set-off arrangements.

Negative pledge undertakings are usually included in loan facility agreements. Breach by a borrower of a negative pledge entitles the lender to bring a damages claim as an unsecured creditor, but breach is unlikely to disturb the security granted in favour of a *bona fide* third party created in breach of the negative pledge.

iii Priorities and subordination

Subordination of debts

A lender may commonly seek subordination of debt owed by the borrower to creditor shareholders, so that the lender's loan ranks in priority to the creditor shareholders' loans. Such subordination is effected by way of contract, often by way of deed of subordination between the borrower, the lender and the creditor shareholders.

Structural subordination is also permissible.

Priority of competing security interests

Priority is a complex matter that depends upon the particular facts and the relevant registrations (if any).

A common priority concern arises where a company grants security by way of two fixed charges over the same debt chose in action to two creditors. The starting point under common law is that the creditor who gives notice first to the debtor takes priority over the other creditor. If that fixed charge is registrable at Companies Registry, then to preserve priority the fixed charge must be registered within the required time period of one month after execution. The Companies Ordinance requires that the instrument of charge must be registered in full. The text of the instrument of charge is therefore available to the public for a small fee.

Although it is unclear how these changes under the Companies Ordinance legislation affect the doctrine of notice, it is expected that registration of an instrument of charge will likely give rise to constructive notice of all the terms in the charge instrument – including negative pledge clauses – on the part of those who may reasonably be expected to search the companies register, including banks, financiers and relevant professionals. Reinforcing the previous sentence, Companies Registry has stated it is 'more important than ever' for lenders to make enquiries and search the companies register for charges. It would appear that, for example, where a company grants a charge over a debt chose in action to a 'first financial institution' and then subsequently grants a charge over the same debt chose in action to a 'second financial institution', then the first financial institution may take priority if the second financial institution would have been aware of the first financial institution's interest had it searched the Companies Registry's register (regardless of whether or not the first financial institution has given notice to the debtor). In a similar way, negative pledges in floating charges may now bind later financial institutions that have a fixed charge interest in the same asset.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Legal limitations on the validity or enforceability of lending and secured arrangements are described below.

If lenders (including via their agents) are put on notice that a borrower may not have properly convened and held the board meeting that authorised the relevant loan and security documents, then the court may find that the documents do not bind the company. Care

needs to be taken by lenders' counsel that there are no irregularities that would put lenders on notice. A particular case (*Moulin Global Eyecare Holdings* [2010] 1 HKC 90) where the courts found a lender had notice of irregularities involved the lender's counsel preparing draft board minutes and (as requested) including in those draft board meetings – prepared prior to the meeting – the list of specified directors of the borrower-listed company who were to attend the meeting. The specified directors were all connected to the controlling shareholder family, and none of the five non-executive directors (including three independent non-executive directors) were included in the list. In the circumstances, which included there being little time to give notice of the meeting to all directors, the court found that the loan and related security documents did not bind the borrower-listed company.

Previous legal opinion concerns with financial assistance, leading to loans and security being unenforceable, no longer apply for documentation entered into on or after 3 March 2014, when Hong Kong's consolidated Companies Ordinance legislation came into effect. Financial assistance remains an offence, and so remains a concern for subsidiary guarantors and subsidiary security providers.

The way in which a non-Hong Kong corporate may execute Hong Kong law governed deeds (such as charges) is more restrictive than most common law jurisdictions. If execution is not by way of the affixation of a common seal or under a power of attorney that is valid in the corporate's place of incorporation, then a reservation may be made in a legal opinion. As from 3 March 2014, the procedure for a Hong Kong-incorporated company to execute a Hong Kong law-governed deed has been relaxed, but the relaxation does not apply to non-Hong Kong corporates.

Although there is no binding Hong Kong case law in this area, Hong Kong practice is to follow the *UK Mercury* case for the steps to take when executing a deed. If signature pages are executed as a deed and the executed signature pages are later attached to the rest of a document expressed to be a deed and governed by Hong Kong law, then a reservation may be made in a legal opinion.

Hong Kong law follows the doctrine of absolute Crown immunity (for the PRC but excluding Hong Kong), and the doctrine of absolute state immunity (for foreign states). Immunity cannot be waived by the parties by way of including a waiver in the underlying agreements. Immunity can, however, be waived (1) in the context of a particular dispute that has already arisen, or (2) in advance, in an international treaty between the foreign state and the forum state. Legal opinions may therefore include assumptions that the parties are not Crown or foreign state entities.

Registry filings are made after the event and so are not up to date. The best evidence for ascertaining directors and members of a company can be found in the statutory books kept by the company, although these are not typically reviewed unless a shareholder is granting a charge over its holding of shares in the company.

Where security is granted, the prohibitions set out in the underlying asset being charged will impact upon whether or not the security can be realised. Obvious concerns are:

- a* a charge over shares in a company where company directors have discretion not to register a transfer of shares; and
- b* security over a contract where that contract does not permit parties to dispose of their interests.

Legal opinions usually set out the relevant registry filings that must be made upon creation of security, and then assume those filings will be made within the prescribed time limits.

Legal opinions cover the valid creation of security, but do not go further to describe the type and ranking of security given the complexities of this area of law.

VI LOAN TRADING

Loan trading is usually carried out by way of novation and assignment, and both methods are catered for in Asia Pacific Loan Market Association primary documentation. Sub-participations and synthetic methods are available but less commonly used.

VII OTHER ISSUES

If a lender is not an authorised institution licensed by the HKMA, then it may fall under the Money Lenders Ordinance (Chapter 163 of the Laws of Hong Kong) if it is carrying on a business in Hong Kong (whether itself or through agents) of making loans, or if it advertises or announces itself as carrying on that business. This legislation seeks to protect consumers against unfair credit transactions, for example, by requiring moneylenders to be licensed, and for moneylenders to use prescribed forms and not to charge compound interest. Breach of the Money Lenders Ordinance may result in the commitment of offences, and underlying transactions being unenforceable. A number of loans are exempted from the above requirements (including the requirement to be licensed in order to lend money). A commonly used exemption is for loans made to a company that has a paid-up share capital of not less than HK\$1 million (or its equivalent in another currency).

A lender who is not an authorised institution licensed by the HKMA must abide by the usury laws set out in the Money Lenders Ordinance, which requires loans and security not to be 'extortionate'. There is a statutory presumption that a transaction is extortionate where the effective rate of interest exceeds 48 per cent per annum.

VIII OUTLOOK AND CONCLUSIONS

Hong Kong's insolvency regime remains creditor-friendly, and there is no specific debtor resolution mechanism in place.

Hong Kong loan volumes remain high, and we expect the same to continue, although the increased prevalence of uncommitted facilities may impact on the use of committed facility agreements.

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Law
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ISBN 978-1-912228-44-7