

Structured finance and securitisation in Hong Kong: overview

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MARKET AND LEGAL REGIME

1. Please give a brief overview of the securitisation market in your jurisdiction. In particular:

- How developed is the market and what notable transactions and new structures have emerged recently?
- What impact have central bank programmes (if any) had on the securitisation market in your jurisdiction?
- Is securitisation particularly concentrated in certain industry sectors?

Hong Kong has a well-developed legal framework and financial market conducive to securitisation.

Securitisations are predominantly mortgage-backed securities involving the Hong Kong Mortgage Corporation Limited (HKMC), which buys mortgages and issues and/or guarantees mortgage-backed issuances, creating a robust secondary market.

The principal regulators for financial markets are the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC). It has not introduced any liquidity schemes or other measures to facilitate securitisation.

2. Is there a specific legislative regime within which securitisations in your jurisdiction are carried out? In particular:

- What are the main laws governing securitisations?
- What is the name of the regulatory authority charged with overseeing securitisation practices and participants in your jurisdiction?

Governing laws

There is no specific legislative regime for securitisation. Securitisation is subject to various Hong Kong laws, depending on the transaction structure, transaction parties, underlying assets and the nature of the offering of the securities.

Relevant Hong Kong statutes include the:

- Securities and Futures Ordinance (Cap. 571) (SFO).
- Companies Ordinance (Cap. 622).
- Law Amendment and Reform (Consolidation) Ordinance (Cap. 23) (LRO).
- Banking Ordinance (Cap. 155).
- Various consumer protection laws (see *Question 15*).

On 1 July 1997, Hong Kong became the Hong Kong Special Administrative Region (HKSAR) of the People's Republic of China (PRC). In *HKSAR v Ma Wai-kwan and others* (29 July 1997), the Hong Kong Court of Appeal decided that the common law and rules of equity of England which applied in Hong Kong as of 30 June 1997 will continue to apply in the HKSAR, subject to their independent development (*Article 8, Basic Law of the HKSAR*):

- Unless they contravene the Basic Law of the HKSAR.
- Subject to any amendment by the HKSAR's legislature.

Some of these laws and rules from England affect securitisations.

With the introduction of the Securities and Futures and Companies Legislation (Structured Products Amendment) Ordinance 2011 (the Amendment Ordinance) "structured products", as defined in the Amendment Ordinance, are now governed by the SFO and must therefore be authorised by the SFC unless they benefit from one of the exemptions under the SFO.

Regulatory authority

There is no securitisation-specific regulatory authority. HKMA is the relevant regulator for financial institutions. Depending on the structure of the securitisation transaction, review or approval from the Securities and Futures Commission or the Hong Kong Stock Exchange (HKEx) may also be required.

REASONS FOR DOING A SECURITISATION

3. What are the main reasons for doing a securitisation in your jurisdiction? In particular, how are the reasons for doing a securitisation in your jurisdiction affected by:

- Accounting practices in your jurisdiction, such as application of the International Financial Reporting Standards (IFRS)?
- National or supra-national rules concerning capital adequacy?
- Risk retention requirements?
- Implementation of the Basel III framework in your jurisdiction?

Usual reasons for securitisation

Cheaper borrowing and credit arbitrage (due to cost-effective funding alternatives) and balance sheet benefits (due to difficulties under International Financial Reporting Standards (IFRS) to achieve de-recognition) are increasingly not primary reasons. Additional reasons include investor reverse inquiry transactions to obtain exposure to credit risk.

Accounting practices

Accounting rules applicable to the originator may influence the structure of a securitisation, including permitting the de-

recognition of assets by the originator. Mandatory sources of accounting practices are:

- The Companies Ordinance, which contains legal requirements for such matters for companies incorporated in Hong Kong.
- Hong Kong Financial Reporting Standards, which include standards and interpretations and are consistent with IFRS (therefore, difficulties under IFRS to achieve de-recognition apply in Hong Kong).
- Any accounting and disclosure requirements of HKEx for companies listed on its main board and on its growth enterprise market.

Capital adequacy

Capital adequacy rules may also influence the structure of a securitisation, including to remove or reduce exposures on a regulated originator's balance sheet.

Capital adequacy is regulated by the HKMA, which is in the process of implementing Basel III in accordance with the Basel Committee on Banking Supervision's timetable, including transitional arrangements. The first phase was implemented on 1 January 2013 and the second phase was implemented on 1 January 2015, with full implementation scheduled for the beginning of 2019. Implementation in Hong Kong is effective under the:

- Banking Ordinance (as amended by the Banking (Amendment) Ordinance 2005).
- Banking (Capital) Rules (as amended by the Banking (Capital) (Amendment) Ordinance 2012).
- Banking (Disclosure) Rules (as amended by the Banking (Disclosure) (Amendment) Rules 2013).

The latest phase sees stricter capital adequacy and liquidity rules implemented in Hong Kong.

THE SPECIAL PURPOSE VEHICLE (SPV)

Establishing the SPV

4. How is an SPV established in your jurisdiction? Please explain:

- **What form does the SPV usually take and how is it set up?**
- **What is the legal status of the SPV?**
- **How the SPV is usually owned?**
- **Are there any particular regulatory requirements that apply to the SPVs?**

SPVs are typically established as limited liability companies. One or more persons can form a company by subscribing to a memorandum of association and complying with the relevant registration requirements (*section 4, Companies Ordinance*).

A duly incorporated company under the Companies Ordinance is a separate legal entity, with the capacity, rights, powers and privileges of a natural person (*section 5A, Companies Ordinance*).

A company is legally owned by its members. Unless transaction requirements dictate otherwise, shares in an SPV are usually held by a trustee on trust for charitable purposes, so that it has an independent legal existence as an "orphan" company. There is no prescribed minimum share capital. However, for practical purposes, this is usually at least HKD1,000 or a foreign currency equivalent.

Hong Kong does not have any SPV-specific laws.

5. Is the SPV usually established in your jurisdiction or offshore? If established offshore, in what jurisdiction(s) are SPVs usually established and why? Are there any particular circumstances when it is advantageous to establish the SPV in your jurisdiction?

SPVs can be established in Hong Kong or offshore. Hong Kong has low tax requirements (*see Question 26*) and benefits from a low interest withholding tax on assets held in the PRC. However, offshore jurisdictions are often used as a matter of practice. The choice depends on a number of factors, including:

- The transaction structure.
- The obligor's location.
- The nature of the underlying assets.

Typical offshore jurisdictions include the Cayman Islands, British Virgin Islands and other jurisdictions with minimal tax and established corporate services industries.

Ensuring the SPV is insolvency remote

6. What steps can be taken to make the SPV as insolvency remote as possible in your jurisdiction? In particular:

- **Has the ability to achieve insolvency remoteness been eroded to any extent in recent years?**
- **Will the courts in your jurisdiction give effect to limited recourse and non-petition clauses?**

It is possible to reduce (but not eliminate) insolvency risk. Methods typically used include:

- Establishing a clean SPV, usually as an orphan entity, with:
 - no operating history to avoid third party creditors; and
 - with limited objects to restrict non-transaction-specific liabilities.
- All creditors agreeing to:
 - limit their recourse to the SPV's available assets;
 - minimise risk of meeting the legal definition of insolvency; and
 - agree to non-petition provisions limiting creditors' rights to take court proceedings (including to petition for insolvency or enforcement) against the SPV.
- Documenting all cash flows and ensuring adequate liquidity and credit enhancement and hedging to minimise the risk of cash flow insufficiency.

The courts in Hong Kong would give effect to limited recourse and non-petition clauses.

Ensuring the SPV is treated separately from the originator

7. Is there a risk that the courts can treat the assets of the SPV as those of the originator if the originator becomes subject to insolvency proceedings (substantive consolidation)? If so, can this be avoided or minimised?

A company incorporated under the Companies Ordinance has a separate legal personality, and there is no formal doctrine of substantive consolidation whereby the SPV's assets are treated as those of another entity to satisfy the other entity's liabilities.

Courts follow the English common law approach whereby, in certain circumstances, the separate legal personality of a company

is disregarded to identify the true shareholders and purpose of a transaction. These circumstances, although undefined, are limited to cases where:

- There is impropriety or dishonesty.
- The incorporation is a "device", "cloak" or "sham", which disguises the true nature of the shareholder, structure or transaction in order to deceive third parties or the courts (*R v Seager* [2009] EWCA Crim 1303).
- There is an element of fraud (*Secretary v Lee Chau-ping & Anr* [2001] 1 HKLRD 49).

To minimise this risk, the following measures are usually taken:

- The SPV is established as insolvency remote (see *Question 6*).
- Commingling of assets with those of the originator is limited or prohibited.
- The SPV has administrative independence from the originator (including independent directors, separate books of account and place of business).

THE SECURITIES

Issuing the securities

8. What factors will determine whether to issue the SPV's securities publicly or privately?

While securities can be offered to the general public, asset-backed securities have almost exclusively been issued privately as selectively marketed securities (that is, securities offered only to professional investors).

9. If the securities are publicly issued:

- **Are the securities usually listed on a regulated exchange in your jurisdiction or in another jurisdiction?**
 - **If in your jurisdiction, please identify the main documents required to make an application to list debt securities on the main regulated exchange in your jurisdiction. Are there any share capital requirements?**
 - **If a particular exchange (domestic or foreign) is usually chosen for listing the securities, please briefly summarise the main reasons for this.**
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Securities can be listed on the HKEx or a regulated foreign exchange.

When listing securities on the HKEx, compliance with the HKEx's listing rules is required. The listing process usually involves filing certain documents, including:

- A prospectus.
- A trust deed constituting the securities.
- An application form.
- Incorporation and constitutional documents for the issuer.

Notably, the documentary requirements for listing selectively marketed securities are less extensive, although a prospectus is, as a matter of practice, still required (as the listing rules for selectively marketed securities require a listing document which contains information investors would customarily expect to see).

There is no minimum share capital requirement for issuers of selectively marketed asset-backed securities.

The choice of listing on a particular stock exchange depends on:

- The jurisdiction of the SPV.
- The investor requirements and preferences.
- Tax considerations.
- The listing rules and regulations and ease of the listing process.

Constituting the securities

10. If the trust concept is not recognised in your jurisdiction, what document constitutes the securities issued by the SPV and how are the rights in them held?

The trust concept is recognised in Hong Kong. Securities are constituted by a trust deed, which contains:

- The covenant to pay the amounts due on the securities by the SPV.
- The terms and conditions of the securities.
- The rights and duties of the trustee.

The rights are held by the trustee for the benefit of the investors.

TRANSFERRING THE RECEIVABLES

Classes of receivables

11. What classes of receivables are usually securitised in your jurisdiction? Are there any new asset classes to have emerged recently or that are expected to emerge in the foreseeable future?

While there are generally no restrictions on the classes of receivables which can be securitised, receivables commonly securitised include:

- Residential mortgages, owing to the role of the HKMC (see *Question 7*).
- Corporate loans.
- Trade receivables.
- Commercial real estate leases and loans.
- Bridge toll receivables.
- Project loans.
- Fund linked receivable.

The transfer of the receivables from the originator to the SPV

12. How are receivables usually transferred from the originator to the SPV? Is perfection of the transfer subject to giving notice of sale to the obligor or subject to any other steps?

Receivables, being choses in action, are usually transferred by assignment, which can be legal or equitable.

Legal assignment. An assignment takes effect in law as a legal assignment if the requirements of section 9 of the LRO are satisfied, that is, the assignment must:

- Be absolute, with the assignor's entire legal interest transferred to the assignee.
- Be in writing under the hand of the assignor.
- Not purport to be by way of charge only.
- Be notified in writing to the debtor.

A legal assignment is enforceable against the seller, the debtor, creditors of the seller, and any subsequent good faith buyer of the receivables.

Equitable assignment. Where not all of the requirements of a legal assignment are satisfied, the assignment may take effect in equity.

Usually, the assignment is structured as a legal assignment except that, for commercial and practical reasons, notice to the debtor is not given, and a contingent notice regime applies. In the absence of notice, such an equitable assignment is only enforceable against the seller and its creditors and not against the debtor (until it is so notified) and generally not against any subsequent buyer of the receivables, if the subsequent buyer notifies the debtor ahead of the original assignee.

Until an equitable assignment is perfected to become a legal assignment, the following applies, among other things:

- The debtor can validly discharge its debt by paying the seller.
- The debtor and the seller can amend the underlying agreement.
- The debtor can raise against the buyer all the defences it could have raised against the seller (including set-off).
- As priority between competing assignments of receivables is determined by the order in which notice of the assignments is given to the debtor and, until notice is given to the debtor, a subsequent assignee (or encumbrance holder) of the receivables takes priority over the buyer if it is:
 - bona fide and has no notice of the earlier assignment when the subsequent assignment or encumbrance is granted; and
 - the first to give notice to the debtor.
- The buyer must join the seller in any legal claim against the debtor.

Receivables can also be transferred by:

- Novation.
- Declaration of trust.
- Sub-participation (although not typically a "true sale" transfer of title (see *Question 16*)).

There are no securitisation-specific rules, requirements or exemptions.

13. Are there any types of receivables that it is not possible or not practical to securitise in your jurisdiction (for example, future receivables)?

There are no specific restrictions or difficulties in securitising any type of receivables, although securitisation of future receivables presents additional legal issues. An assignment for valuable consideration of adequately identified future receivables can be an equitable assignment only (future receivables cannot be legally assigned), with the assignment taking place when the receivables come into existence. Notice is still required to perfect such assignments. However, on the originator's insolvency, an agreement to assign future receivables automatically transfers receivables as they arise only where there is nothing else to be done by the originator to earn the receivables (see *Question 17*).

14. How is any security attached to the receivables transferred to the SPV? What are the perfection requirements?

Security attached to receivables is usually transferred by assignment (see *Question 12*) and is usually assigned at the same

time as the receivables. The debtor's consent may be required if there are contractual restrictions or prohibitions on the transfer of the security.

Additional formalities may be required to perfect the assignment depending on the secured property. For example, equitable interests in land can only be created or disposed of by an instrument in writing, signed by the person creating or disposing of the interest (*section 5, Conveyancing and Property Ordinance (Cap. 219) (CPO)*). The transfer of mortgages requires registration with the Hong Kong Land Registry under the Land Registration Ordinance (Cap. 128) within one month from the date of assignment to preserve priority over any subsequent interest created.

Prohibitions or restrictions on transfer

15. Are there any prohibitions or restrictions on transferring the receivables, for example, in relation to consumer data?

Contractual restrictions

If a receivable is silent on the right to assign (that is, it neither prohibits nor expressly permits assignment), the seller can generally sell the receivable without the consent of the debtor except in certain limited exceptions (for example, assignments prohibited by public policy).

Contractual restrictions on transfer are generally enforceable. A breach of such restrictions renders the transfer ineffective against the debtor, unless the debtor's prior consent has been obtained, although the transfer will still be effective as between the assignor and assignee. An assignor selling in breach of a contractual restriction may be liable to the debtor for breach of contract. Additionally, the assignee may be liable to the debtor in tort for inducing the seller's breach of contract if the assignee was aware of the contractual restrictions.

Legislative restrictions

The processing of information about natural persons is controlled by the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO). Any person who collects or uses personal information relating to an individual, on the basis of which it is practicable to identify that individual, is deemed a "data user" under the PDPO. An SPV acquiring receivables which continue to be serviced by the seller is likely to be a data user, and must comply with the data protection principles set out in Schedule 1 of the PDPO. In April 2013, criminal liability was introduced in respect of the new direct marketing provisions, which deal with unauthorised transfers of personal data to third parties for direct marketing purposes.

Consumer protection is provided through various laws, including the:

- **Code of Banking Practice.** Purchasers that are authorised institutions under the Banking Ordinance must comply with the Code of Banking Practice when dealing with private individuals.
- **Money Lenders Ordinance (Cap. 163).** Excessive interest is presumed extortionate and unenforceable.
- **Control of Exemption Clauses Ordinance (Cap. 71).** Parties are restricted in limiting liability, including contractual liability, in certain circumstances (for example, liability for death or personal injury caused by negligence, and failure to satisfy the reasonableness test under the Control of Exemption Clauses Ordinance).
- **Consumer Council Ordinance (Cap. 216).** Consumers can lodge complaints against suppliers of goods and services with the Consumer Council.

- **Supply of Service (Implied Terms) Ordinance (Cap. 457).** Certain implied terms are imposed on suppliers of services to consumers.
- **Unconscionable Contracts Ordinance (Cap. 458).** Unconscionable contracts are not enforceable.

Avoiding the transfer being re-characterised

16. Is there a risk that a transfer of title to the receivables will be re-characterised as a secured loan? If so:

- **Can this risk be avoided or minimised?**
- **Are true sale legal opinions typically delivered in your jurisdiction or does it depend on the asset type and/or provenance of the securitised asset?**

Courts will examine a contract to determine the relationship between the parties to it and therefore re-characterisation is possible. For a sale of receivables to be treated as a true sale, it must avoid being classed as a sham transaction or re-characterised as a secured loan. Provided that the terms in the sale contract are consistent with a true sale, it will be upheld as such even if the economic effect may be indistinguishable from a secured loan.

In *Chase Manhattan (Asia) Limited v First Bangkok City Finance Limited [1988] 1 HKC 97*, the Hong Kong Court of Appeal considered and applied the principles set out in the English case of *Re George Inglefield [1933] Ch.1*, which established the following three essential differences between a sale and a secured loan:

- In a sale, the vendor is not entitled to get back the subject matter of the sale by returning the purchase price (the grantor of security is entitled to the return of secured property on repayment of the secured loan).
- In a secured loan, if the secured party realises the secured property for more than the secured debt, it must account to the grantor of security for the surplus (in a sale, the purchaser can sell the property with no obligation to account for any profit to the vendor).
- In a secured loan, if the secured party realises the secured property for less than the secured debt, the grantor of security is still liable for the balance (in a sale, the vendor is not liable for any loss the purchaser makes on re-sale).

While providing a true sale opinion depends on the structure of the transaction, a true sale opinion should be able to be issued provided that:

- The sale agreement provides for the absolute assignment of all rights relating to the receivables to the assignee with title and rights of collection vesting with the assignee.
- The originator has no right to re-acquire the assets by repayment of the purchase price and all risks and rewards associated with the receivables vest in the SPV, so that the SPV is neither obliged to account for any profit on the assets nor has any recourse to the originator for any losses on the assets.

In a securitisation, the following generally do not prevent the issuance of a true sale opinion:

- An obligation to repurchase assets, provided it is:
 - a remedy for breach of warranty and relates to the state of the asset on sale and not subsequent performance; and
 - not a method of transferring loss or profit.
- Customary profit strip techniques.
- Customary credit enhancements implemented by the originator.
- Originator control of collections as servicer for the SPV.

- Derivative transactions between the originator and SPV.

Ensuring the transfer cannot be unwound if the originator becomes insolvent

17. Can the originator (or a liquidator or other insolvency officer of the originator) unwind the transaction at a later date? If yes, on what grounds can this be done and what is the timescale for doing so? Can this risk be avoided or minimised?

Hong Kong's insolvency laws do not provide for an automatic stay or a general right to set aside a transaction on a party's insolvency. The Hong Kong courts will only set aside a transaction where a transaction falls within certain statutory provisions.

Subject to the following paragraphs, the insolvency of the originator does not affect the rights of the buyer in a true sale of existing receivables. In a true sale, the buyer can collect, transfer or otherwise exercise ownership rights over receivables acquired even after the originator has become subject to an insolvency proceeding. However, in a true sale involving an agreement to assign future receivables, after insolvency of the seller, if there are any outstanding actions by the seller before the receivables are transferred, the buyer cannot rely on the seller continuing to carry out those actions. If a transaction is not a true sale, the sale agreement may be re-characterised as a secured loan or an unsecured loan.

A grant of registrable security may be void against a liquidator and other creditors of the seller if not registered within five weeks after its creation (*section 80, Companies Ordinance*).

Under certain Hong Kong statutory provisions, the following transactions may be invalid:

- **Insolvency.** A disposition of a company's property made after the commencement of the winding-up of the company is void under section 182 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) unless the court orders otherwise.
- **Unfair preference.** Any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within a suspect period (six months or, for an unfair preference to an associate, two years) before the commencement of its winding-up which is an unfair preference may be invalid (*section 266B, Companies (Winding Up and Miscellaneous Provisions) Ordinance*). An unfair preference is essentially a transaction where a debtor does (or suffers) anything that puts a creditor into a better position on the insolvency of the debtor. A court will not make any order to rescind or reverse transactions that took place during the suspect period if the transaction was entered into by the company in good faith and not to defraud its creditors, and the terms of the transaction are bona fide arm's-length commercial terms entered into for bona fide commercial reasons. Notably no purchase, made bona fide and without fraud, of any interest in property of any kind in Hong Kong will be open or set aside merely on the ground of undervalue (*section 59, CPO*).
- **Fraudulent disposition.** Every disposition of property made with intent to defraud creditors is voidable at the instance of any person thereby prejudiced (*section 60(7), CPO*).
- **Onerous property.** Any onerous property of a company may be disclaimed by a liquidator, subject to court approval. For this purpose, onerous property means any unprofitable contract, and any other property which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act (*section 268, Companies (Winding Up and Miscellaneous Provisions) Ordinance*).

- **Fraudulent trading.** Any person who carries on any business of a company with intention to defraud creditors is personally liable for the company's liabilities (*section 275, Companies (Winding Up and Miscellaneous Provisions) Ordinance*). The court has wide discretion as to the nature of the relief that can be granted (including unwinding the transaction).
- **Invalid floating charge.** A floating charge (*see Question 19*) is invalid if (*section 267, Companies (Winding Up and Miscellaneous Provisions) Ordinance*):
 - the chargor is insolvent at the time, or as a result of, entry into the transaction; and
 - a winding-up commences within 12 months of the execution of the security.

However, the charge is valid to the extent of the money paid to the chargor plus contractual interest.

Establishing the applicable law

18. Are choice of law clauses in contracts usually recognised and enforced in your jurisdiction? If yes, is a particular law usually chosen to govern the transaction documents? Are there any circumstances when local law will override a choice of law?

Courts in Hong Kong generally give effect to contracting parties' choice of law (typically Hong Kong or English law), provided it is:

- Made in good faith.
- Not contrary to Hong Kong public policy.
- Not made to evade the laws of the jurisdiction with real and substantial connection with the subject matter of the contract.

However, irrespective of the choice of law, the courts in Hong Kong will apply Hong Kong mandatory rules and legal principles where applicable.

SECURITY AND RISK

Creating security

19. Please briefly list the main types of security that can be taken over the various assets of the SPV in your jurisdiction, and the requirements to perfect such security.

The SPV can create the following types of security over its assets:

- **Mortgage.** Legal title to assets is transferred by way of security (or, less commonly, title documents to the assets are transferred by way of security to create an equitable mortgage). This is effected in the same way as an assignment (*see Question 12*) although there is provision for re-assignment on discharge of the debt.
- **Charge.** This is an equitable right enabling the secured party to appropriate secured property to discharge the debt in the event of a default from proceeds, with no transfer of ownership or possession. A charge may be fixed or floating:
 - in a fixed charge, the encumbrance attaches to specific assets immediately (or, for future assets, immediately when they come into existence). The chargor cannot deal with, control, or encumber the charged assets without the consent of the chargee; and
 - in a floating charge, the chargor retains control over secured property and the right to use, alienate and rehypothecate the assets in its ordinary course of business, unless and until the floating charge crystallises into a fixed charge on the occurrence of specific events. On crystallisation, a fixed

charge is attached to the secured property then available. A floating charge ranks behind a fixed charge on insolvency of the chargor, and is subject to section 267 of the Companies (*Winding Up and Miscellaneous Provisions*) Ordinance (*see Question 17*).

- **Pledge.** Possession of tangible assets is transferred with power to sell the assets on the pledgor's default.
- **Lien.** A lien gives a right to retain possession until payment, with no right to sell.

If a Hong Kong company grants a security of a type listed in section 334 of the Companies Ordinance, the grantor must register the security with Companies Registry within one month after its creation (*section 335, Companies Ordinance*). This registration should constitute good notice to interested third parties. If the grantor fails to register within one month, the charge may lose its priority, and will be void against the liquidator and any creditor of the chargor. Notably section 336 of the Companies Ordinance applies the requirements of section 335 of the Companies Ordinance to foreign companies registered in Hong Kong as non-Hong Kong companies where they:

- Grant a registrable security.
- Acquire property in Hong Kong which is the subject of a registrable security.

With the implementation of the new Companies Ordinance, certified copies of certain prescribed charge instruments must now be registered with the Hong Kong Companies Registry, and as such, the terms of the charge will be publicly available through a search. This statutory development appears to reverse the legal position established in the Hong Kong case of *ABN Amro Bank NV v Chiyu Banking Corporation Ltd and Ors [2000] 3 HKC 381*, which limited the doctrine of constructive notice to the existence of a registered charge, but not of its terms. Therefore, it is likely that a person with constructive notice of a registered charge will now also be deemed to have constructive notice of its terms (including any prohibition of disposal or negative pledge clauses therein), although there is no case law on point as yet.

A mortgage over real property (or a security interest in mortgage loans creating an interest in real property) must be registered with the Land Registry as an instrument affecting an interest in land (*section 2, Land Registration Ordinance*). If it is not registered, it is void against any subsequent bona fide buyer or mortgagee for valuable consideration (but not between the parties to the security).

A charge over book entry interests in securities held in a clearing system can be security against the chargor's rights in the clearing system (rather than in the securities themselves). This can be perfected by arrangement with the clearing system, either directly or indirectly through an intermediary custodian. A security interest in negotiable instruments held outside the clearing systems can be granted by a pledge of the instruments. Delivery of non-negotiable instruments (such as the share certificates of registered shares), together with an executed blank transfer form will operate as an equitable charge. Alternatively, a legal or equitable mortgage over the securities can be created.

A charge and equitable mortgage are vulnerable if either:

- The legal interest in the charged assets is sold to a bona fide buyer who buys it for value without any prior notice of the charge on the assets.
- The equitable interest in the charged assets is sold by way of assignment to a bona fide third party giving notice.

20. How is the security granted by the SPV held for the investors? If the trust concept is recognised, are there any particular requirements for setting up a trust (for example,

**the security trustee providing some form of consideration)?
Are foreign trusts recognised in your jurisdiction?**

The SPV typically grants security to a security trustee, who holds it on trust for the secured creditors (including investors).

The common law trust concept is recognised. A trust is generally recognised if it is lawful and:

- There is a manifest intention to create a trust.
- There are ascertainable beneficiaries.
- The property subject to the trust is specified with reasonable certainty and properly vested in the trustee.

Issues relating to the existence of a foreign trust, or the extent of rights under a foreign trust, are matters determined by the proper law of the trust. However, the courts will enforce a foreign trust if the trustees are subject to the jurisdiction of Hong Kong (*Chellaram v Chellaram* [1985] 1 All ER 1043).

Credit enhancement

21. What methods of credit enhancement are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the credit enhancement techniques set out in the Guide to a standard securitisation (Guide)?

The methods of credit enhancement in the Guide are commonly used. However, with implementation of risk retention requirements in the US and the EU (see *Question 29*), credit enhancement may be influenced by the need for the originator to retain economic risk in the securitised assets.

Risk management and liquidity support

22. What methods of liquidity support or cash reservation are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the provision of liquidity support as set out in the Guide?

The methods of liquidity support in the Guide are commonly used.

CASH FLOW IN THE STRUCTURE Distribution of funds

23. Please explain any variations to the cash flow index accompanying Diagram 9 of the Guide that apply in your jurisdiction. In particular, will the courts in your jurisdiction give effect to "flip clauses" (that is, clauses that allow for termination payments to swap counterparties who are in default under the swap agreement, to be paid further down the cash flow waterfall than would otherwise have been the case)?

The cash flow index is typical for Hong Kong securitisations.

Profit extraction

24. What methods of profit extraction are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the profit extraction techniques set out in the Guide?

Profit extraction typically follows the methods in the Guide.

THE ROLE OF THE RATING AGENCIES

25. What is the sovereign rating of your jurisdiction? What factors impact on this and are there any specific factors in your jurisdiction that affect the rating of the securities issued by the SPV (for example, legal certainty or political issues)? How are such risks usually managed?

Hong Kong's current sovereign ratings are:

- Standard & Poor's:
 - AAA (long-term);
 - A-1+ (short-term).
- Moody's:
 - Aa1 (long-term);
 - NR (short-term).
- Fitch:
 - AA+ (long term);
 - F1+ (short term).

Hong Kong maintains ratings separate from those of PRC due to:

- Hong Kong's status as a special administrative region of China.
- Hong Kong's considerable autonomy in relation to economic and financial policies (although rating agencies have noted its ratings are constrained by China-related sovereign risks).

Rating agency criteria for governments focus on fiscal and monetary policy, regulatory framework, political and legal risks, and foreign currency control. Hong Kong's strong external financial position, fiscal prudence and sound banking system are cited favourably by rating agencies.

TAX ISSUES

26. What tax issues arise in securitisations in your jurisdiction? In particular:

- **What transfer taxes may apply to the transfer of the receivables? Please give the applicable tax rates and explain how transfer taxes are usually dealt with.**
 - **Is withholding tax payable in certain circumstances? Please give the applicable tax rates and explain how withholding taxes are usually dealt with.**
 - **Are there any other tax issues that apply to securitisations in your jurisdiction?**
 - **Does your jurisdiction's government have an inter-governmental agreement in place with the United States in relation to FATCA compliance, and will this benefit locally-domiciled SPVs?**
-

There are generally no taxes on the sale of receivables.

There is no withholding tax on interest payments by obligors in relation to receivables.

Stamp duty is generally not chargeable on the sale of receivables, but is chargeable on transfers of interests in land and stock and on the issue of bearer instruments. In February 2013, stamp duty rates for the sale or transfer of immovable property were revised, ranging from 1.5% up to 8.5%.

There is no VAT, sales tax or other similar taxes on the sale of goods, services or receivables, or on fees for collection agent services.

RECENT DEVELOPMENTS AFFECTING SECURITISATIONS

27. Please give brief details of any legal developments in your jurisdiction (arising from case law, statute or otherwise) that have had, or are likely to have, a significant impact on securitisation practices, structures or participants.

Synthetic securitisations are possible in Hong Kong, with a typical structure involving the SPV issuing credit-linked notes, investing the proceeds and entering into a portfolio credit derivative referencing an asset portfolio. Upon a credit event in relation to the asset portfolio, the SPV liquidates sufficient collateral to make a protection payment to the derivative counterparty. On maturity, the credit-linked notes are redeemed using proceeds from liquidation of the remaining collateral.

OTHER SECURITISATION STRUCTURES

28. What other structures, including synthetic securitisations, are sometimes employed in your jurisdiction?

While all structures described in the Guide can be used in Hong Kong, following the recent global financial crisis, the market has shifted to clear, simple structures.

REFORM

29. Please summarise any reform proposals and state whether they are likely to come into force and, if so, when. For example, what structuring trends do you foresee and will they be driven mainly by regulatory changes, risk management, new credit rating methodology, economic necessity, tax or other factors?

There are no current securitisation specific reforms.

The HKMA is continuing to implement Basel III stage by stage in HK (see *Question 3, Capital adequacy*).

There is still continued scrutiny by Hong Kong regulators of retail structured products and the relevant disclosure regime continues to evolve.

30. Has the nature and extent of global, regional and domestic reforms had a positive or negative affect on revitalising securitisation in your jurisdiction?

The introduction of the Amendment Ordinance (see *Question 2*) and the concept of a "structured product" may have an impact on the securitisation market since the ability to rely on the safe harbours offered by the Companies Ordinance has been narrowed. However, on a practical level, market participants seem to experience no major issues, relying on the "professional investors" exemption offered by the SFO.

ONLINE RESOURCES

Department of Justice Bilingual Laws Information System

W www.legislation.gov.hk

Description. This website is maintained by the Hong Kong Department of Justice and provides both English and Chinese language versions of all current Hong Kong legislation.

Practical Law Contributor profiles



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