

The International Comparative Legal Guide to: Securitisation 2007

A practical insight to cross-border Securitisation Law



Published by Global Legal Group with contributions from:

Accura Advokataktieselskab

Arendt & Medernach

Attorneys at law Borenus & Kempainen Ltd.

Attorneys at law Foigt & partners / Regija Borenus

Babbé

Baker & McKenzie Raisbeck, Lara, Rodríguez & Rueda

Boga & Associates

Branko Maric Law Office

Bugge, Arentz-Hansen & Rasmussen

Camilleri Preziosi

Caspi & Co.

Cervantes, Aguilar-Alvarez y Sainz, S.C.

Cleary Gottlieb Steen & Hamilton LLP

Cornelius, Lane & Mufti

Corrs Chambers Westgarth

Dave & Girish & Co.

Dorda Brugger Jordis

Eiger Capital Limited

Estudio Beccar Varela

Estudio Echecopar

Freshfields Bruckhaus Deringer

Gárdos, Füredi, Mosonyi, Tomori

Headrick Rizik Alvarez & Fernandez

Karanovic & Nikolic

Kim & Chang

Latham & Watkins

Lejins, Torgans & Partners

Lenz & Staehelin

Levy & Salomão Advogados

Liniya Prava

Loyens & Loeff N.V.

Luiga Mody Hääl Borenus

Macchi di Cellere Gangemi

Magister & Partners

Mayer, Brown, Rowe & Maw LLP

Morais Leitão, Galvão Teles, Soares da Silva & Associados

Morrison & Foerster LLP

Mourant du Feu & Jeune

Nishimura & Partners

Odvetniki Selih & partnerji, o.p., d.n.o.

Pachiu & Associates

Patton Moreno & Asvat

Philippi, Yrarrázaval, Pulido & Brunner

Porobija & Porobija

ProI & Asociados

Slaughter and May

Soewito Suhardiman Eddymurthy Kardono

Stikeman Elliott LLP

Tods Murray LLP

Valko & Partners

Wardynski & Partners

Hong Kong



Jeffrey H. Chen



Kingsley Ong

Mayer, Brown, Rowe & Maw LLP

1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the debtor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of historic relationships?

There is no specific evidentiary requirement in order to make a debt obligation enforceable. A contract is not enforceable unless there is (i) an intention to create legal relations, (ii) consideration, and (iii) sufficient certainty regarding the terms of the contract. In the absence of an express agreement, an agreement may be implied by the conduct of the parties. The existence of a contract may be inferred from a historic relationship between the parties. An invoice may constitute evidence of a contract, particularly within the context of a historic relationship.

- 1.2 Consumer Protections. Do your country’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; or (c) provide other noteworthy rights to consumers with respect to receivables owing by them?

Under the **Money Lenders Ordinance (Cap. 163)**, s.25(3), any agreement for the repayment of a loan or for the payment of interest on a loan in respect of which the effective rate of interest exceeds 48% per annum shall, having regard to that fact alone, be presumed to be a transaction which is extortionate. Section 24 of the Ordinance further provides that where the interest rate exceeds 60% per annum, no agreement for the repayment of any loan or for the payment of interest on any loan and no security given in respect of any such agreement or loan is enforceable. Breach of s.24 of the Ordinance is a criminal offence carrying a maximum penalty of HK\$5,000,000 fine and 10 years imprisonment. However, s.24 of the Ordinance does not apply to any loan made to a company that has a paid up share capital of at least HK\$1,000,000. The Ordinance also does not apply to an “authorised institution” within the meaning of the **Banking Ordinance (Cap. 155)**.

A provision setting an additional interest rate payable on default is not enforceable if the amount constitutes a penalty and not a genuine and reasonable pre-estimate of the loss likely to be suffered as a result of the default.

Other statutory rights provided to consumers include the **Unconscionable Contracts Ordinance (Cap 458)**, the **Supply of Services (Implied Terms) Ordinance (Cap. 457)**, the **Consumer**

Council Ordinance (Cap. 216), and the **Control of Exemption Clauses Ordinance (Cap. 71)**. These rights are outlined under question 8.3 below.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency are there different requirements and laws that apply to the sale of receivables?

Contracts entered into by the government and other public bodies for the procurement of goods and services and the execution of public works are to some extent governed by special statutory and common law rules. The procedural rules in respect of actions against the government are governed by the **Crown Proceedings Ordinance (Cap. 300)**.

Although the ordinary principles of contract law are relevant to contracts made with the government and public authorities, certain special considerations attach to the contractual capacity of the government and other public bodies. Public bodies cannot enter into contracts which are beyond their powers. A public body cannot by contract fetter its right or duty to exercise a discretion vested in it by law, although this principle appears to be limited to contracts which are incompatible with the discharge of its functions and so will not normally include commercial contracts. The provision of funds by the Legislative Council is not a condition precedent to the validity of contracts entered into by the government, although payment cannot be made until the expenditure has been authorised by the Legislative Council (s.32(1) of the Ordinance).

2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified. If the seller and the debtor do not specify a choice of law in their receivables contract, what are the main principles in your country that will determine the governing law of the contract?

In the absence of any express choice of law, the courts will search for the legal system with which the facts of the matter in dispute has the most “real and substantial connection”. Under Hong Kong law, Hong Kong courts may refer to English court decisions when adjudicating cases, and English common law authority prior to 30 June 1997 would be imported.

2.2 **Base Case.** If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, and the seller and the debtor choose the law of your jurisdiction to govern the receivables contract, is there any reason why a court in your country would not give effect to their choice of law?

No there is none.

2.3 **Freedom to Choose Other Law.** If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, can the seller and the debtor choose a different country's law to govern the receivables contract and the receivables?

Parties to a contract are free to choose any law they wish so long as it is bona fide, legal and is not against public policy. Even if a foreign law is chosen to govern the contract, Hong Kong courts will continue to apply mandatory rules of Hong Kong law to it. For example, if the contract relates to interests in real property in Hong Kong, it is likely that the Hong Kong courts would apply the law in Hong Kong to determine the issues.

2.4 **Seller Resident.** If the seller is resident in your country, and the seller and the debtor choose the law of your country to govern their receivables contract, will a court in your country give effect to their choice of law?

As described in question 2.3, the parties to a contract are generally free to decide which country's law should govern their contract.

2.5 **Debtor Resident.** If the debtor is resident in your country, and the seller and the debtor choose the law of your country to govern their receivables contract, will a court in your country give effect to their choice of law?

As described in question 2.3, the parties to a contract are generally free to decide which country's law should govern their contract.

3 Choice of Law - Receivables Purchase Agreement

3.1 **Freedom to Choose Other Law.** If your country's law governs the receivables, and the seller sells the receivables to a purchaser in another country, and the seller and the purchaser choose the law of the purchaser's country or a third country to govern their sale agreement, will a court in your country give effect to their choice of law?

Generally yes. The principles set out in question 2.3 would apply. However, note that certain issues regarding transfer and perfection of receivables will generally be determined by the law governing the receivables, irrespective of the law governing the sale agreement.

3.2 **Other Advantages.** Conversely, if another country's law governs the receivables, and the seller is resident in your country, are there circumstances where it would be beneficial to choose the law of your country to govern the sale agreement?

This depends on how the sale agreement would be treated by

comparison if it were governed by the law of another country. However, note that certain issues regarding transfer and perfection of the receivables will generally be determined by the governing law of the receivables, irrespective of the governing law of the sale agreement (see question 3.3 below).

3.3 **Effectiveness.** In either of the cases described in questions 3.1 or 3.2, will your country's laws apply to determine (i) whether the sale of receivables is effective as between the seller and the purchaser; (ii) whether the sale is perfected; and/or (iii) whether the sale is effective and enforceable against the debtors?

(i) The law governing the contract of sale, together with mandatory rules of Hong Kong law, will determine whether the sale is effective as between the seller and the purchaser.

(ii)/(iii) The choice of law for an agreement to sell receivables applies only to the determination of the rights and obligations between the seller and the purchaser. The rights and obligations between the purchaser and the underlying debtors will be governed by the law of the receivables. In particular, any requirements to perfect the sale will be governed by the law of the receivables.

4 Asset Sales

4.1 **Sale Methods Generally.** In your country what is (are) the customary method(s) for a seller to sell accounts receivables to a purchaser?

Accounts receivable are generally sold by assignment. A sale of receivables by assignment requires an agreement (whether in writing or otherwise) between the assignor and the assignee (with valuable consideration and a clear intention to assign). An agreement for the assignment of future receivables will usually take effect as the receivables come into existence.

There are two types of assignment: legal assignment and equitable assignment.

If certain procedural requirements set out in the **Law Amendment and Reform (Consolidation) Ordinance (Cap. 23)**, s.9 are satisfied - i.e. the assignment is absolute, in writing under the hand of the assignor (not purporting to be by way of charge only) and notice in writing of the assignment is given to the debtor - then the assignment will take effect "in law" (i.e. legal assignment).

However, for commercial and practical reasons, it is not uncommon for sellers of receivables to prefer to avoid giving notices to debtors. Therefore, transfer of ownership of receivables by equitable assignment (which does not require notices to debtors) is commonly used.

A receivable may also be sold by novation (which requires the agreement of all parties to the underlying contract as well as the purchaser) or by a declaration of trust.

4.2 **Perfection Generally.** What formalities are required generally for the sale of accounts receivable to be perfected? Are there any additional or other formalities required for the sale of accounts receivable to be perfected against any subsequent good faith purchasers for value of the same accounts receivable from the seller?

For an equitable assignment of receivables to be perfected, the requirements of the **Law Amendment and Reform (Consolidation) Ordinance (Cap. 23)**, s.9 described in question 4.1 above must be satisfied. This usually means that written notice

must be given to the debtor.

Priority between competing assignments of accounts receivable is determined by the order in which notice of the assignments is given to the debtor, not the order of the assignments themselves (except where the later assignee is not bona fide and was aware of the earlier assignment at the time that he entered into the later assignment). Therefore, until notice of assignment is given to the debtor, an assignment is vulnerable in terms of priority to any other assignment of which notice is given to the debtor.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

An equitable assignment of interests relating to land must be in writing (**Conveyancing and Property Ordinance (Cap. 219), s.5**). To ensure that the legal interest in the mortgage loan is not subject to a claim by a third party, a prudent buyer would also ensure that the transfer of the mortgage loan is registered at the relevant Land Registry office.

A negotiable instrument is transferred by an act of negotiation, such as delivery or endorsement. The transfer of bills of exchange and promissory notes are dealt with in the **Bills of Exchange Ordinance (Cap. 19)**. Generally, a bearer instrument is transferred by delivery and a registered instrument is transferred by entry in the appropriate register.

With regard to consumer loans, see question 8.3.

4.4 Debtor Notification. Must the seller or the purchaser notify debtors of the sale of receivables in order for the sale to be an effective sale against the debtors?

A debtor must be notified of an assignment before the receivable is enforceable against it by the purchaser. Until it receives notice, among other things:

- (i) the debtor may validly discharge its debt by paying the seller;
- (ii) the debtor and the seller may amend the underlying agreement;
- (iii) the debtor may raise against the purchaser all the defences it could have raised against the seller (including set-off); and
- (iv) a subsequent assignee or encumbrancer of the seller's receivables will take priority over the purchaser if such assignee or encumbrancer did not have notice of the assignment of the seller's receivables at the time the subsequent assignment or encumbrance is granted and is the first to give notice of its assignment or encumbrance to the relevant debtor.

The purchaser will only be able to sue the debtor in its own name if it has given notice and the assignment otherwise fulfils the criteria for an assignment pursuant to the **Law Amendment and Reform (Consolidation) Ordinance (Cap. 23)**.

4.5 Debtor Consent. Must the seller or the purchaser obtain the debtors' consent to the sale of receivables in order for the sale to be an effective sale against the debtors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment?

If a receivable contract is silent on the right to assign (i.e. it does not prohibit assignment nor expressly permits assignment), the creditor can generally sell the receivable without the consent of the debtor

except in certain limited exceptions (e.g. assignment is prohibited by public policy).

If the receivable contract does contain an anti-assignment provision, and the purported transfer is in breach of this prohibition, the transfer will be ineffective against the debtor.

4.6 Liability to Debtor. If the seller sells receivables to the purchaser even though the receivables contract expressly prohibits assignment, will the seller be liable to the debtor for breach of contract?

If the purchaser is aware of the anti-assignment provisions in the receivables contract and nonetheless proceeds with the assignment, the purchaser could be liable under the tort of inducing a breach of contract. However, given that the assignment is ineffective against the debtor, the debtor is unlikely to be adversely affected.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., debtor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics?

A contract to sell receivables must describe the receivables so that they are capable of being identified at the time of the purported assignment (or at the time they come into existence, for a sale of future receivables). For an assignment contract to be valid, it must be clear what is being assigned (see question 1.1). If the sale is by declaration of trust, the subject matter of the trust (i.e. the receivables being sold) must be sufficiently certain and the respective interests of the purchaser and any other beneficiaries of the trust must be capable of determination at any time. There is no required form for a sale document. There is no requirement for the receivables being sold to share objective characteristics.

4.8 Economic Effects on Sale. What economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; and (c) control of collections of receivables without jeopardising perfection?

For a sale of receivables to be treated as perfected and as an insolvency-safe "true sale", it must avoid being classed as a sham transaction or re-characterised as a secured loan. It must also not be vulnerable on insolvency as further discussed in section 6 below.

In the Hong Kong case of **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**. The three essential differences between a sale and a secured loan, as set out in **Re George Inglefield**, are:

- (i) *In a transaction of sale, the vendor is not entitled to get back the subject-matter of the sale by returning to the purchaser the money that has passed between them. In the case of a mortgage or charge, the mortgagor is entitled, until he has been foreclosed, to get back the subject-matter of the mortgage or charge by returning to the mortgagee the money that has passed between them.*
- (ii) *If the mortgagee realises the subject-matter of the mortgage for a sum more than sufficient to repay him, with interest and the costs, the money that has passed between him and the mortgagor he has to account to the mortgagor for the surplus. If the purchaser sells the subject-matter of the*

purchase and realises a profit, he has not got to account to the vendor for the profit.

- (iii) *If the mortgagee realises the mortgage property for a sum that is insufficient to repay him the money that he has paid to the mortgagor, together with interest and costs, then the mortgagee is entitled to recover from the mortgagor the balance of the money, either because there is a covenant by the mortgagor to repay the money advanced by the mortgagee, or because of the existence of the simple contract debt which is created by the mere fact of the advance having been made. If the purchaser were to resell the purchased property at a price which is insufficient to recoup him the money that he paid to the vendor, he would not be entitled to recover the balance from the vendor.*

An obligation to repurchase assets that are in breach of warranties will not contravene the requirement that the seller does not have the right to reacquire the property, provided that the obligation is seen as a remedy for breach of warranty and not a method of transferring loss or profit, so the warranty must relate to the state of the asset on sale and not its subsequent performance.

The requirement that the purchaser not be obliged to account to the seller for profit on the sale of the property should not preclude customary profit strip techniques used in securitisations.

The requirement that the seller not be obliged to make up any shortfall if the property is sold at a loss should not preclude certain customary credit enhancements that may be given by the seller in securitisations. The entry by the seller into derivative transactions with the purchaser to hedge the purchaser's interest rate risks should not prevent a true sale occurring. In securitisation transactions, it is common for the seller to retain control of collections (as servicer or collection agent for the purchaser) and this should not prevent a true sale.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables?

An agreement for continuous sales of receivables is enforceable between the seller and the purchaser as an agreement to assign. It cannot be a legal assignment under s.9 of the **Law Amendment and Reform (Consolidation) Ordinance (Cap. 23)**. The agreement will operate to assign the receivables on the agreed date in the future. Notice is still required to perfect the assignment and the assignment is therefore vulnerable in terms of priority to intervening assignments of which notice is given to the debtor (see question 4.2).

If the original agreement simply prescribes a mechanism for future sales of receivables, and the agreement of the parties is still required at the time of transfer, the original agreement is not enforceable. The enforceable contract would come into existence at the time an offer to sell receivables (on previously agreed terms) was accepted.

4.10 Future Receivables. Can the seller commit in an enforceable manner (both prior to and after its insolvency) to sell receivables to the purchaser that come into existence after the date of the sale contract (as in a "future flow" securitisation)?

The present assignment of adequately identified future property for valuable consideration is possible in equity (**Holroyd v Marshall (1862) 11 ER 999** and **Tailby v Official Receiver (1888) 13 App. Cas. 523**).

An assignment for valuable consideration of receivables that do not exist at the time of the assignment will be treated as an agreement

to assign in equity. It cannot be a legal assignment under s.9 of the **Law Amendment and Reform (Consolidation) Ordinance (Cap. 23)**. This agreement will operate to assign the receivables as soon as they come into existence (although notice is still required to perfect the assignment).

See question 6.5 below for the effect of the seller entering into insolvency proceedings before the receivables come into existence.

4.11 Related Security. What additional formalities must be fulfilled for the concurrent transfer of related security to be enforceable? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The additional formalities depend on the nature of the related security that is being transferred. For example, an equitable assignment of interests relating to land must be in writing (**Conveyancing and Property Ordinance (Cap. 219), s.5**). The transfer of mortgages would also require registration with the Land Registry offices.

5 Security Interests

5.1 Back-up Security. Is it customary in your country to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

The Hong Kong true sale analysis (based on English law principles set out in question 4.8 above) is critically dependent on consistency of treatment - the documents, operation of the transaction and the actions of the parties need to be consistent in all respects with the transaction being a sale rather than a secured loan. Taking a security interest requires registration (see question 5.2 below). Carrying out a "back-up" security registration as if the transaction had created a registrable charge might prejudice the true sale analysis, since it would indicate (a) that the parties were not sure of the true sale analysis and (b) that the parties did not intend to operate in all respects consistently with the true sale analysis. It is therefore not market practice to take a "back-up" security interest in a Hong Kong law true sale securitisation.

Instead of taking a security interest in a true sale transaction, as a "back-up", the seller may agree that, if at any time it holds any property, interest, right, benefit or proceeds that it had agreed to sell to the purchaser under the receivables sale agreement (e.g. because the purported sale was flawed), it will hold such property, interest, right, benefit and/or proceeds on trust for the purchaser.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of your country, and for such security interest to be perfected?

If security over a receivable is created by way of charge, the assignor may be required to register the charge within 5 weeks after its creation (**Companies Ordinance (Cap. 32), s.80**). Failure to register when required may result in a loss of priority and the charge will be void as against the liquidator and any creditor of the company. The registration requirement applies to any charge by a company registered in Hong Kong and to any charge over property in Hong Kong by a company incorporated outside Hong Kong but

with an established place of business in Hong Kong (**Companies Ordinance (Cap. 32), s.91**).

5.3 Purchaser Security. What are the formalities for the purchaser granting a security interest in receivables and related security under the laws of your country, and for such security interest to be perfected?

An assignment is not perfected until notice is given to the debtor. Until notice is given, the assignment is subject to disadvantages mentioned in question 4.4 above.

Alternatively, the receivables may be charged by way of security. A charge is not a transfer of ownership interest in the receivables, but it is an encumbrance on the receivables. It is enforceable against the seller and third parties and gives the chargee preferential access to the receivables on the insolvency of the chargor. The degree of preference depends on whether the charge is a fixed charge or floating charge. A charge is vulnerable to the sale of the legal interest in the receivables to a bona fide purchaser for value without notice of the charge or, until notice of the charge is given to the underlying debtor, to the sale of an equitable interest in the receivables by way of assignment with notice to the debtor. The chargor may be required to register a charge over receivables within 5 weeks after its creation (see question 5.2 above) and such registration constitutes notice.

Under a fixed charge, the receivable (which must be ascertained (or ascertainable) and definite) is appropriated to the satisfaction of the debt between the chargor and the chargee immediately, or immediately upon its coming into existence. A floating charge attaches to a class of receivables, including future receivables, until an event occurs which causes the charge to crystallise, at which point it fastens on the assets then comprised in the class, effectively becoming a fixed charge. A fixed charge has a higher priority on insolvency than a floating charge.

5.4 Recognition. If the purchaser grants a security interest in the receivables under the laws of the purchaser's country or a third country, and that security interest is valid and perfected under the laws of that other country, will it be treated as valid and perfected in your country?

Whether a security interest over Hong Kong property under a contract governed by the laws of a different country will be treated as valid and perfected in Hong Kong will depend on (i) the nature of the underlying property and (ii) whether there are any additional mandatory requirements under Hong Kong law to perfect security over the relevant property (any mandatory Hong Kong law requirements must be satisfied).

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to promissory notes, mortgage loans, consumer loans or marketable debt securities?

A security interest in mortgage loans creating an interest in real property should be registered with the Land Registry as an instrument that affects interest in land in Hong Kong, pursuant to the **Land Registration Ordinance (Cap. 128), s.2**. Where such a security interest should be registered but is not registered, it will be absolutely null and void as against any subsequent bona fide purchaser or mortgagee for valuable consideration of the secured property but not as between the parties to the security.

Security granted over book-entry interests in securities held in a clearing system may be security against the chargor's rights in the

clearing system as opposed to the securities themselves, and may be perfected by arrangement with the clearing system, either directly or indirectly through an intermediary custodian.

A security interest in negotiable instruments, including bearer debt securities and promissory notes, held outside the clearing systems, may also be granted by a pledge of the instruments. A pledge is a transfer of possession of the instruments with the power to sell the instruments on default of the pledgor. 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 mortgage over the securities may be created.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will your country's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables ("automatic stay")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected?

Subject to the discussion in question 6.3 below, if there is a "true sale" of existing receivables, the insolvency of the seller will not affect the rights of the purchaser. In a "true sale", the purchaser will not be prohibited from collecting, transferring or otherwise exercising ownership rights over receivables acquired by true sale even after the seller has become subject to an insolvency proceeding.

With regard to an agreement to assign future receivables, this will operate to transfer those receivables when they come into existence. However, after insolvency of the seller, if there are any actions required by the seller under the agreement before the receivables are transferred, the purchaser cannot rely on the seller continuing to carry out those actions.

If the sale is not a "true sale", the sale agreement may be recharacterised as a secured loan or an unsecured loan. A grant of security would be void against a liquidator and other creditors of the seller if not registered within 5 weeks after its creation (**Companies Ordinance (Cap. 32), s.80**).

6.2 Insolvency Official's Powers. If there is no automatic stay, under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

In the case of a "true sale", the insolvency official would not have that power.

6.3 Suspect Period. Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding?

(i) **Unfair preference.** Under the **Companies Ordinance (Cap. 32), s.266B**, any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within 6 months (or in the case of an unfair preference to an "associate", 2 years) before the commencement of its winding up which is an unfair preference may be invalid. 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. The **Conveyancing and Property Ordinance (Cap. 219)**, s. 59, provides that no “purchase, made bona fide and without fraud of any interest in property of any kind in Hong Kong shall be open or set aside merely on the ground of undervalue”.

(ii) **Fraudulent disposition.** Under the **Conveyancing and Property Ordinance (Cap. 219)**, s. 60(1), every disposition of property made with intent to defraud creditors shall be voidable at the instance of any person thereby prejudiced.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

There is no general doctrine of substantive consolidation under Hong Kong law. Only in very limited circumstances would the separate legal personality of a company be ignored (e.g. fraud).

6.5 Effect of Proceedings on Future Receivables. What is the effect of the initiation of insolvency proceedings on (a) sales of receivables that have not yet occurred or (b) on sales of receivables that have not yet come into existence?

Once a seller enters into insolvency proceedings, a previous agreement to assign future receivables will only continue automatically to transfer receivables as they arise where there is nothing further to be done by the seller in order to earn the receivables.

7 Special Rules

7.1 Securitisation Law. Does your country have laws specifically providing for securitisation transactions? If so, what are the basics?

There are no laws specifically providing for securitisation transactions in Hong Kong.

On 1 July 1997, Hong Kong became the Hong Kong Special Administrative Region (HKSAR) of the People’s Republic of China (PRC). On 4 April 1990, the PRC National People’s Congress (NPC) adopted the **Basic Law of HKSAR**. Under Article 8 of the Basic Law, the laws of Hong Kong in force at 30 June 1997 (i.e. common law, rules of equity, ordinances, subordinate legislation and customary law) shall be maintained, except for any that contravene the Basic Law and subject to any amendment by the legislature of HKSAR. Under Article 160 of the Basic Law, the laws of Hong Kong in force at 30 June 1997 shall be adopted as laws of the HKSAR except for those which are declared by the NPC Standing Committee to be in contravention of the Basic Law. On 23 February 1997, the Standing Committee made a decision not to adopt the Application of English Law Ordinance (Cap. 88) which applied common law and rules of equity of England to Hong Kong. In **HKSAR v Ma Wai-kwan and others (29 July 1997)**, the Hong Kong Court of Appeal took the view that the effect of that Standing Committee decision was to repeal the English Law Ordinance as from 1 July 1997, and that the common law and rules of equity of England which applied in Hong Kong on 30 June 1997 continues to apply in the HKSAR, subject to their independent development.

7.2 Securitisation Entities. Does your country have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to (a) requirements for establishment of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There are no laws specifically providing for establishment of special purpose entities for securitisation in Hong Kong.

7.3 Non-Recourse Clause. Will a court in your country give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

A limitation on the liabilities of the special purpose entity to a creditor is likely to be valid. Under Hong Kong law, Hong Kong courts may refer to English court decisions when adjudicating cases, and English common law authority prior to 30 June 1997 would be imported.

7.4 Non-Petition Clause. Will a court in your country give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

It is likely that a non-petition clause is valid, although there is little authority either way in Hong Kong law (or English law, which Hong Kong courts may refer to when adjudicating cases). The most effective method of enforcing such a provision would be prior injunctive relief. However, such relief is discretionary and a Hong Kong court would have to consider whether such a clause was contrary to public policy as an attempt to oust the jurisdiction of the court or the insolvency laws of Hong Kong. It is possible that a Hong Kong court would deal with a winding-up petition even if it was presented in breach of a non-petition clause.

7.5 Independent Director. Will a court in your country give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

A restriction or limitation in the constitutional documents of a company on the ability of the directors to bring insolvency proceedings may be invalid as a matter of public policy, as a fetter on the proper regulation of a limited company.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in your country, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any license or its being subject to regulation as a financial institution in your country? Does the answer to the preceding question change if the purchaser does business with other sellers in your country?

Where the receivables which are purchased constitute a business

which is regulated by either the **Money Lenders Ordinance (Cap. 163)** or the **Banking Ordinance (Cap. 155)**, the purchaser will be required prior to becoming the legal owner of such receivables, to obtain the necessary licences under those Ordinances.

In general, the mere purchase and ownership of receivables (without any form of physical presence in Hong Kong, either through the establishment of an office or having employees present in Hong Kong) should not in itself be regarded as a carrying of business in Hong Kong.

8.2 Data Protection. Does your country have laws restricting the use or dissemination of data about or provided by debtors? If so, do these laws apply only to consumer debtors or also to enterprises?

The processing of information about living individuals is controlled by the **Personal Data (Privacy) Ordinance (Cap. 486)**. The Ordinance does not cover information about enterprises.

Any person who collects or uses personal information relating to an individual from which it is practicable to identify the individual is deemed to be a “data user” under the Ordinance. A special purpose vehicle acquiring receivables which nevertheless continue to be serviced by the seller is likely to be a “data user”, and will have to comply with the “data protection principles” set out in Schedule 1 of the Ordinance.

Individuals have the right to request access to personal data held on them by data controllers and to request that the data is rectify if it is incorrect.

Banks and other authorised institutions subject to the Code of Banking Practice, are also subject to a duty of privacy concerning handling information on their customers.

8.3 Consumer Protection. If the debtors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of your country? Briefly, what is required?

There is limited consumer protection legislation in Hong Kong that would apply to the purchase of receivables.

The **Money Lenders Ordinance (Cap. 163)**, s.24 which prohibits excessive interest rates was discussed in question 1.2 above.

Under the **Unconscionable Contracts Ordinance (Cap. 458)**, a term in an agreement where a party “deals as consumer” that is “unconscionable” may become partially or wholly unenforceable.

There are other provisions under Hong Kong law which seeks to protect consumers (for example, the **Supply of Services (Implied Terms) Ordinance (Cap. 457)** which imposes certain implied terms on suppliers of services to consumers, and the **Consumer Council Ordinance (Cap. 216)** which established the Consumer Council where consumers can lodge complaints against suppliers of goods and services).

The **Control of Exemption Clauses Ordinance (Cap. 71)** restricts the ability of a party to limit its liability, including contractual liability. A party cannot limit its liability for death or personal injury caused by negligence. Where the other party is a consumer, one can limit its liability for other damage caused by negligence or for breach of contract only insofar as the term satisfies a test of reasonableness set out in the Ordinance.

Where a bank purchaser is an “authorised institution” within the meaning of the **Banking Ordinance (Cap. 155)**, it is required to comply with the Code of Banking Practice in connection with dealing with personal customers (i.e. private individuals).

8.4 Currency Restrictions. Does your country have laws restricting the exchange of your country’s currency for other currencies or the making of payments in your country’s currency to persons outside the country?

Hong Kong does not exercise exchange controls (apart from restrictions on payments to parties subject to United Nations, Hong Kong or People’s Republic of China sanctions implemented and effective under Hong Kong law - in which case the obligations of the parties under the relevant document or relevant transfer or payment may be unenforceable or void).

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the debtors to the seller or the purchaser be subject to withholding taxes in your country? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

There is no withholding tax on interest payments by debtors to the seller or purchaser in respect of receivables.

9.2 Seller Tax Accounting. Does your country require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

Hong Kong does not have such a requirement. In Hong Kong, the mandatory sources of generally accepted accounting principles (GAAP) are (i) the **Companies Ordinance (Cap. 32)** for companies incorporated in Hong Kong, (ii) the **Hong Kong Financial Reporting Standards (HKFRS)** which have all been converged with the International Financial Reporting Standards (IFRS) issued by the IASB, and (iii) the accounting and disclosure requirements of The Stock Exchange of Hong Kong Limited for companies listed on its main board and on its growth enterprise market. Hong Kong Accounting Standard 8 (HKAS 8, which is identical to IAS 8) provides that in the absence of a Standard or an Interpretation that specifically applies to a transaction, management shall use its judgement in developing and applying an accounting policy that results in information that is: (a) relevant to the economic decision-making needs of users; and (b) reliable, in that the financial statements: (i) represent faithfully the financial position, financial performance and cash flows of the entity; (ii) reflect the economic substance of the transaction and not merely the legal form; (iii) are neutral, i.e. free from bias; (iv) are prudent; and (v) are complete in all material respects. The Hong Kong Institute of Certified Public Accountants has also issued a **Financial Reporting Framework and Standard for Small and Medium-sized Entities** which may be used by small private Hong Kong companies as well as overseas-incorporated entities that do not have public accountability and qualify on the basis of size thresholds given in the Standard.

9.3 Stamp Duty, etc. Does your country impose stamp duty or other documentary taxes on sales of receivables?

Stamp duty is generally not chargeable on sale of receivables. The **Stamp Duty Ordinance (Cap. 117)** imposes stamp duty on transfers of interest in land. The rates are sliding rates ranging from HK\$100 (for prices paid for the property up to HK\$2,000,000) up to 3.75% (for prices paid for the property in excess of HK\$6,000,000). Besides land transfers, stamp duty is also

chargeable on transfer of stock and the issue of bearer instruments.

- 9.4 Value Added Taxes.** Does your country impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Hong Kong currently does not impose value added tax, sales tax or other similar taxes on sales of goods or services, on the sale of receivables or on fees for collection agent services. In 2006, the Hong Kong government proposed the introduction of sales tax in Hong Kong but this was abandoned due to widespread public opposition.

- 9.5 Purchaser Liability.** If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims against the purchaser or on the receivables or collections for the unpaid tax?

There are no taxes on the sale of receivables in Hong Kong.



Jeffrey H. Chen

Mayer, Brown, Rowe & Maw LLP
7/F Gloucester Tower, The Landmark
15 Queen's Road Central
Hong Kong

Tel: +852 3763 7007
Fax: +852 3763 7500
Email: jchen@mayerbrownrowe.com
URL: www.mayerbrownrowe.com/hongkong

Jeff Chen is a partner in the Hong Kong office of Mayer, Brown, Rowe & Maw LLP and heads the firm's Asian Securitisation and Structured Finance practice. He focuses on cross-border financing structures of all types and on engineering various types of hybrid instruments. Jeff advises banks, monolines, swap providers, rating agencies, and corporations on major securitisations in Asia, both cash and synthetic. Jeff is also familiar with local law peculiarities across Asian jurisdictions and coordinates regional local law compliance issues such as netting and collateral. As an American lawyer, Jeff has experience with the issues that typically arise under U.S. securities laws and regulations, including Regulation S, Rule 144A, and the 1940 Act. Jeff also advises clients on compliance with Regulation AB and other rules applicable to asset-backed securities in the United States. Jeff is an Attorney in the District of Columbia and New York, and a Solicitor of Hong Kong. Jeff is fluent in Mandarin Chinese.

- 9.6 Doing Business.** Assuming that the purchaser conducts no other business in your country, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the debtors, make it liable to tax in your country?

The **Inland Revenue Ordinance (Cap. 112)** provides that "profits tax" is payable "at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong ... from such trade, profession or business". In general, if the purchaser conducts no other business in Hong Kong, it should not be deemed to be "carrying on a trade, profession or business in Hong Kong".

Acknowledgment

The authors would like to acknowledge the research assistance of Ms. Kelleigh Poon in the preparation of this chapter.



Kingsley Ong

Mayer, Brown, Rowe & Maw LLP
7/F Gloucester Tower, The Landmark
15 Queen's Road Central
Hong Kong

Tel: +852 3763 7009
Fax: +852 3763 7500
Email: kong@mayerbrownrowe.com
URL: www.mayerbrownrowe.com/hongkong

Kingsley Ong is a senior associate in the Hong Kong office of Mayer, Brown, Rowe & Maw LLP. He recently relocated from its London office and brings along with him extensive European experience. He specialises in all types of structured finance, including securitisation of trade receivables, credit cards, auto-loans, real estate assets, whole businesses, master trust structures, and asset-backed commercial paper conduits; and has acted on behalf of sponsors, issuers, servicers, arrangers, underwriters, swap counterparties, enhancement providers, liquidity providers, trustees and rating agencies. Kingsley currently sits on the accounting and tax committee of the Asia-Pacific Securitisation Association (APSA). He is a Barrister and Solicitor (with full higher rights of audience) of England and Wales, an Advocate and Solicitor of Singapore, and currently a Registered Foreign Lawyer in Hong Kong. Kingsley is fluent in Mandarin and Cantonese Chinese.

MAYER
BROWN
ROWE
& MAW

Mayer, Brown, Rowe & Maw LLP is one of the largest law firms in the world with over 1,500 attorneys in 14 offices across North America, Europe and Asia. Widely acknowledged as having one of the premier securitization practices in the world, we have securitised virtually every asset type that can be securitised, including asset-classes such as operating leases, future export receivables and charged-off consumer loans, CDOs and various types of credit default swap and risk transfer structures. We regularly represent issuers, underwriters and placement agents, investors, trustees, servicers, credit and liquidity enhancers, multi-seller conduits and rating agencies, and are continuously active in securitisation in North America, Latin America, Europe, and Asia.