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Hong Kong

LENDING & SECURED FINANCE

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This country-specific Q&A provides an overview of lending & secured finance laws and regulations applicable in Hong Kong.

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HONG KONG
LENDING & SECURED FINANCE

1. Do foreign lenders require a licence/regulatory approval to lend into your jurisdiction or take the benefit of security over assets located in your jurisdiction?

Lending into Hong Kong

Any person, not being an "authorized institution" authorised by the Hong Kong Monetary Authority under the Banking Ordinance (Cap. 155) carrying on business as a money lender in Hong Kong must obtain a money lender's licence in accordance with the Money Lenders Ordinance (Cap. 163) (**"MLO"**), unless one of the exemptions set out in the MLO applies (including loans secured by charges registrable under the Companies Ordinance (Cap. 622) (**"CO"**). However, even though there is no legal authority on this point, it is arguable that the MLO does not have extra-territorial effect, so a lending business carried on outside Hong Kong does not need an MLO licence. This can be the case even if the borrower is incorporated and/or doing business in Hong Kong or the loan is disbursed in Hong Kong, if the lender otherwise operates solely from outside Hong Kong. But the law is not clear, so a cautious view is that the MLO could require a licence if any part of a money lending transaction is carried on in or from, or involves any action in, Hong Kong.

There is also a general corporate registration requirement for "carrying on business" in Hong Kong pursuant to the Business Registration Ordinance (Cap. 310). The test for carrying on business in Hong Kong is not expressly defined, other than to expressly include a company incorporated in Hong Kong or registered in Hong Kong as a registered non-Hong Kong company, and is therefore not precise. However, case law indicates that the threshold is low. Any form of commercial activity is sufficient. The existence of business premises is probably not an essential feature. A business can be carried on through an independent agent. Probably the incurrence of legal obligations within Hong Kong is necessary. As the Business Registration Office (**"BRO"**) is an office of the Inland Revenue Department and the primary purpose of registration is to put the business on the radar of the tax authority (though it also serves to enable persons dealing with the business to find out with whom they are dealing), the test is likely to be based on whether potentially taxable activities are being carried on in Hong Kong. A lender needing to register with the BRO in fact has an obligation only to complete, sign and deliver to the BRO the required application form within 1 month after the business starts (or in the case where the lender is registered as a registered non-Hong Kong company, 1 month after such registration (*see below*). This is not an approval process and the BRO will later issue a business registration certificate.

Further, there is a requirement to register as a registered non-Hong Kong company where a lender has established a place of business in Hong Kong pursuant to the CO. The test for establishing a place of business in Hong Kong is not expressly defined in the CO and is therefore not entirely precise. However, case law indicates that (a) the term "establishing a place of business" is not the same as carrying on business in the jurisdiction and the expression points to the company having "a local habitation of its own", (b) the establishment of a place of business connotes a degree of permanence or recognisability as being a location of the company's business, (c) the term "business" should be interpreted in the general sense of activities, and not confined to the narrow sense of commercial transactions, and (d) the business carried on must be activities which fall within the company's paramount or subsidiary objects. A company needing to register with the Hong Kong Companies Registry in fact has an obligation only to complete, sign and deliver to the Hong Kong Companies Registry the required application form, containing the particulars prescribed by procedural regulations and details of at least one person who is proposed to be an authorized representative on registration of the non-Hong Kong company, and certain supporting documents, within 1 month after the place of business is established. The supporting documents include a certified copy of each of the company's constitutional document(s), incorporation certificate and (if publication of accounts or delivery of accounts to a

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person for public inspection is required under the law of the place of incorporation of the company, or the law of any other jurisdiction where the company is registered as a company, or the rules of any stock exchange or similar regulatory bodies in that jurisdiction that impose that requirement) latest published accounts. This is not an approval process and the Companies Registry will later issue a registration certificate.

Taking of security situated in Hong Kong

It is not necessary for a lender to obtain a licence / regulatory approval solely by reason of taking the benefit of security over assets located in Hong Kong.

2. Are there any laws or regulations limiting the amount of interest that can be charged by lenders?

s24 of the MLO makes it illegal for any person (whether a money lender (as defined in the MLO) or not) to lend or offer to lend money at any effective rate of interest which exceeds 60% per annum and makes any agreement for the repayment of any loan or the payment of interest on any loan and any security therefor unenforceable in any case in which the effective rate of interest exceeds such rate. s25 of the MLO provides that a Hong Kong court may, having regard to all the circumstances, "reopen the transaction so as to do justice between the parties" if the transaction is "extortionate". For this purpose, a loan in respect of which the effective rate of interest exceeds 48% per annum is presumed to be "extortionate".

3. Are there any laws or regulations relating to the disbursement of foreign currency loan proceeds into, or the repayment of principal, interest or fees in foreign currency from, your jurisdiction?

No. There is no foreign exchange control in Hong Kong. There is also no limit or restriction on the disbursement of foreign currency loan proceeds into, or the repayment of principal, interest or fees in foreign currency from, Hong Kong.

4. Can security be taken over the following types of asset: i. real property (land), plant and machinery; ii. equipment; iii. inventory; iv. receivables; and v. shares in companies incorporated in your jurisdiction.

Security can be taken over all of the following types of assets. The type of security applicable to the relevant asset type is elaborated below.

The general rule is that the taking of security is governed by (in the case of intangible assets) the governing law of the relevant security document or (otherwise) the law of the place where the asset which is subject to security is situated (the *lex situs* rule) at the time of creation of the security.

Hence, security over real property (land), plant, machinery, equipment, inventory and receivables situated in Hong Kong and shares in Hong Kong company will typically be governed by Hong Kong law.

Real Property

The majority of land in Hong Kong is held on a leasehold tenure under leases granted by the Hong Kong Government. Government leases can (but do not necessarily) restrict dealings relating to the land granted under those leases without the Government's consent and subject to compliance of certain requirements set out therein.

Security can be taken over real property by way of a legal mortgage or equitable mortgage.

Legal mortgage: A legal mortgage over real estate is created by way of a legal charge, in writing and executed as a deed. It gives the protection, powers and remedies traditionally given to a mortgagee, including foreclosure and the equity of redemption. However, the mortgagee cannot take possession before default.
Equitable mortgage: An equitable mortgage can be created by depositing title deeds of the real estate with the mortgagee. Where an equitable mortgage is executed as a deed, the equitable mortgagee enjoys the same powers and remedies as a legal mortgagee on the mortgagor's default, except that the mortgagee has no power to sell the real estate because an equitable mortgagee cannot execute a legal assignment of the mortgaged assets.

Plant and Machinery

The common forms of security over plant and machinery are fixed charge (provided that the chargee exerts sufficient control over the secured asset and the chargor cannot deal with the secured asset without the consent of the chargee) and/or floating charge (a charge on a fluctuating body of assets which remain under the management and control of the chargor, and which the chargor has the right to withdraw from the security

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despite the existence of the charge).

The ability to take effective control will depend, to an extent, on the size, type and location of the assets. Hence, in practice, the security is often in the form of a floating charge, except in the case of a very large/fixed piece of machinery. In order to successfully establish control, it may be wise to affix notification plaques clearly to such assets over a certain value, and to notify third parties that such assets have been charged.

Please refer to "**Plant and Machinery**" sub-section of our response to Question 4 i. above.

Security can be taken over inventory by way of floating charge or fixed charge (provided the chargee exerts sufficient control over the secured asset (which rarely happens in practice)).

Security over inventory poses certain practical issues. Control is often difficult to effect if the assets are required in the chargor's day-to-day business. There are also other issues, for example where goods are stored on leased premises, a consent from the landlord to access the premises may be required. In addition, it may be difficult to enforce a charge upon goods in transit, particularly if shipped internationally.

In the event that inventory subject to a charge is mixed with (for example, stored together with) unsecured inventory, care should be taken to ensure that the inventory subject to the charge is identifiable and can be distinguished from unsecured inventory (such as physically securing the goods, placing stickers on goods and/or notifying the borrower's customers, trading partners and warehouse owners/managers of the security).

Security can be taken over receivables through assignment by way of security, fixed charge (provided the chargee exerts sufficient control over the secured asset) or floating charge. Receivables are typically secured in favour of a chargee by way of charge (as it may sometimes be difficult to obtain consent for assignment where restrictions exist in the documentation creating them) or, where no restrictions exist in the documentation creating them, security in the form of assignment would usually be coupled with a restriction on the chargor stipulating that it can only collect its receivables in the ordinary course of its business and it must pay the proceeds of such collection into a specified (blocked, segregated) collection account. Provided that the receivables are sufficiently identifiable at the time the security is entered into, there is no need to enter into updated security or submit lists of receivables on an ongoing basis prior to enforcement.

Unless the requirements for a legal assignment have been fulfilled (being (a) the assignment is in writing under the hand of the assignor; (b) the assignment is absolute; (c) the assignment is notified in writing to the person against whom the assignor could enforce the assigned rights; (d) the assignment must not purport to be by way of charge only and (e) the intention of the assignor to transfer ownership rights to the assignee must be clear), an assignment by way of security will only take effect as an equitable assignment. Absence of notification of either an assignment or charge, an underlying debtor may discharge its debt by payment to the assignor/chargor rather than to the secured party. From a practical perspective, this means that the notices will need to be served as early as possible after execution of the assignment (thus perfecting the legal assignment pursuant to s9 of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23)).

Following a series of cases culminating in *National Westminster Bank plc v Spectrum Plus Limited and others [2005] UKHL 41* (and confirmed in *Re Harmony Care Homes Limited (in administrative receivership) [2009] EWHC 1961 (Ch)*) it has been held that a fixed charge may be created over receivables (and the proceeds of those receivables paid into a bank account) only if the secured party has sufficient control over those proceeds. Even though UK cases are not binding in Hong Kong, they are considered as persuasive authorities and they are treated with "great respect" as decided by the Hong Kong Court of Final Appeal in *Solicitor v Law Society of Hong Kong [2008] 2 HKC 1.*

The "sufficiency" of control will be determined by the courts on a case by case basis, but the current view is that sufficient control will be achieved by blocking the account into which the proceeds of the receivables are paid from day one so that the chargor will not have the authority to withdraw funds from the account without first obtaining the chargee's consent for withdrawal. The secured party will be the sole authorised signatory with rights to direct activities in relation to the account and the account bank should agree to only take instructions from the secured party with respect to the account.

Directly held shares/securities, where a chargor (or its nominee) is the registered holder: Security can be taken over such shares by way of a fixed charge (provided the chargee exerts sufficient control over the secured asset) and/or floating charge. Legal mortgages (whereby the title to the shares is transferred to the mortgagee) over shares may also be taken, but due to certain responsibilities and commercial implications linked with the mortgagee becoming the owner of such shares, this form of security is not often used.

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In practice, chargees take an equitable mortgage and reserve the ability to perfect their share charge by (a) holding the original share certificate(s), (b) obtaining pre-executed blank instrument(s) of transfer and contract notes from the shareholder and (c) (if required) amending the constitutional documents of the company whose shares are being charged to: (i) remove any right that the directors of the relevant company have to refuse to register a transfer in an enforcement scenario; (ii) remove any rights of pre-emption on a sale/transfer of the shares; and (iii) (less commonly) disapply any liens over fully paid shares. The pre-executed blank instrument(s) of transfer and contract notes and original share certificate(s) would be retained by the chargee who could, on enforcement, complete the transferee section of the instrument(s) of transfer and contract notes and deliver these to the company for registration.

Indirectly held shares/securities: shares/securities listed in Hong Kong can be held in the Central Clearing and Settlement System ("**CCASS**"), administered by the Hong Kong Securities Clearing Company Limited ("**HKSCC**"). Shares held with CCASS are registered in the name of a HKSCC nominee company and recorded by the HKSCC as being held in a CCASS participant's account.

For shares/securities listed in Hong Kong, a depositor has proprietary rights over securities held by a CCASS participant within CCASS. As such, the security interest most commonly granted over securities held within CCASS will be an equitable mortgage/charge over the security collateral provider's proprietary interest in those securities. In addition, the mortgage/charge usually includes an assignment by way of security of its rights against CCASS or the CCASS participant (including the rights in respect of the underlying securities account) and a charge over the related securities account. To perfect the assignment/charge, notice of the assignment/charge must be given to the CCASS participant.

5. Can a company that is incorporated in your jurisdiction grant security over its future assets or for future obligations?

A Hong Kong incorporated company may grant security over future assets, provided that it is sufficiently identified. A legal mortgage cannot be granted over future assets as the security provider does not possess a proprietary interest in those assets. However, it is possible to take equitable security over future assets, provided that those future assets are clearly identified.

Future obligations may be secured, provided they fall within the contemplation of the chargor at the time of the chargee taking the security (and all future obligations contemplated in the underlying document will be secured). Care would need to be taken at the time of any future amendments to the underlying obligations to ensure any obligations arising after such amendments fall within the scope of the security. Otherwise, it would be necessary for the security provider to further charge/mortgage/assign the underlying assets to cover such future obligations when they come into effect.

6. Can a single security agreement be used to take security over all of a company's assets or are separate agreements required in relation to each type of asset?

Subject to the *lex situs* rule (see our response to Question 4 above) and our comments below, it is possible to use a single Hong Kong law security agreement to take security over all of a Hong Kong company's assets situated in Hong Kong. However, under Hong Kong law, a Hong Kong ship mortgage must be in the prescribed form, and it is common to supplement the form (which only contains some basic details of the parties of the underlying vessel) with a separate security deed. Similarly, it is necessary for the relevant party to execute a separate mortgage over real property after acquiring such real property to facilitate registration of it at the Hong Kong Land Registry.

7. Are there any notarisation or legalisation requirements in your jurisdiction? If so, what is the process for execution?

In general, it is not necessary for the security documents to be notarised, legalised and/or apostilled. However, in certain circumstances, it may be necessary to provide certain notarised supporting document to facilitate registration of the security document with the registry of relevant foreign jurisdictions.

8. Are there any security registration requirements in your jurisdiction?

If the security provider is incorporated as a Hong Kong company or registered in Hong Kong as a registered non-Hong Kong company, and the asset falls into one of the registrable categories (covering any floating charge and fixed security over most, but not all, asset types), a certified copy of the instrument creating or evidencing the security over that asset, together with a statement

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of the particulars of that security, must be registered within one month after the date of creation against the company at the Hong Kong Companies Registry. Such obligation on the registered non-Hong Kong company to register the particulars of the charge at the Companies Registry does not apply if the underlying property was ***not*** in Hong Kong when the charge was created by the registered non-Hong Kong company.

In addition to the registration requirement at the Hong Kong Companies Registry, for the following asset types, the following perfection, protection and/or priority steps are also necessary or desirable:-

– **real estate:** registration at Hong Kong Land Registry – **trade marks, patent or registered design:** registration at the applicable register – **aircraft:** there is no register of aircraft mortgages in Hong Kong. However, it is market practice to notify the Civil Aviation Department in Hong Kong of the security interest – **ship:** registration at the Hong Kong Shipping Registry

9. Are there any material costs that lenders should be aware of when structuring deals (for example, stamp duty on security, notarial fees, registration costs or any other charges or duties), either at the outset or upon enforcement?

Registration costs in Hong Kong are minimal. Such fees can be summarised as follows:-

– Registration of a security document at Hong Kong Companies Registry – HK$340 – Registration of a real property mortgage at Hong Kong Land Registry – HK$450 or HK$230 (depending on the value of consideration) – Registration of a ship mortgage at the Hong Kong Shipping Registry – Free of charge – Registration of a security document at the Trade Marks Registry – HK$800 – Registration of a security document at the Patents Registry – HK$325 – Registration of a security document at the Designs Registry – HK$590 Hong Kong does not currently impose stamp duty or other documentary, transfer or similar taxes on the granting of a loan. Pursuant to s4(1) of the Stamp Duty Ordinance (Cap. 117) ("SDO"), only instruments specified under a "head of duty" in the First Schedule to the SDO are subject to stamp duty. The heads of duty are:

(a) *Real Property:* immovable property (i.e. instruments in respect of real property);

(b) *Equities:* Hong Kong stock (i.e. shares, stocks, debentures, loan stocks, funds, bonds or notes, units under a unit trust scheme; and any right, option or interest in or in respect of any of the foregoing, subject to certain exemptions);

(c) *Bearer Instruments:* Hong Kong bearer instruments (i.e. any instrument to bearer by delivery of which any stock can be transferred, subject to certain exceptions); and

(d) *Duplicates:* duplicates and counterparts of the above. No stamp duty is payable in connection with the taking of security (unless the share mortgages over shares in the Hong Kong stock take the form of legal mortgages, then a nominal duty of HK$5 will be chargeable on each instrument of transfer transferring the legal title to the lender or its nominee), but any transfer of the beneficial interest in shares and real property at the time of enforcement (including a sale of a mortgaged property) will attach ad valorem stamp duty.

10. Can a company guarantee or secure the obligations of another group company; are there limitations in this regard?

Apart from any prohibition as may be stipulated under the company's articles of association and the requirement that there must be commercial benefit to the party providing the guarantee or third party security (not to the group as a whole), there is no general limitation on the ability of a company guaranteeing or securing the obligations of another group company in so far as such "group company" is a subsidiary of the company giving the guarantee or security.

To mitigate the risk of a shareholder challenging the guarantee or security provided, especially in the case of upstream and cross-stream guarantee and security, a shareholders' resolution should be obtained (in addition to the necessary directors' resolution). However, shareholders' approval will not block a validity challenge by creditors or liquidator.

11. Are there any issues that lenders should be aware of when requesting guarantees (for example, financial assistance or lack of corporate benefit)?

Financial Assistance

As a general rule, a Hong Kong company or any of its Hong Kong-incorporated subsidiaries cannot directly or indirectly provide financial assistance:

- for any acquisition of its shares; or
- to reduce or discharge any liability incurred

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for such acquisition (there being no time limit for which refinancing takes place).

The meaning of the term “financial assistance” includes financial assistance given by way of loan, transfer of rights in respect of loans, guarantee, security, indemnity, release, waiver, gift or other financial assistance if the net assets of the company are reduced to a material extent by the giving of the assistance or if the company has no net assets. Under the CO, a company (whether listed or unlisted) is allowed to provide financial assistance to another party to acquire the company’s own shares or the shares of its Hong Kong incorporated holding company if, before the giving of giving assistance, the directors of the company resolve that (a) the company should give the assistance; (b) it is in the best interests of the company to give the financial assistance; and (c) the terms and conditions under which the assistance is to be given are fair and reasonable to the company, and one of the following conditions is met:

- the proposed financial assistance, and all other financial assistance previously given and not repaid, is in aggregate not more than 5% of the paid up share capital and reserves of the company (as disclosed in the most recent audited financial statements of the company) (i.e. shareholders funds) (s283 CO);
- the proposed financial assistance is approved by written resolution of all members of the company (s284 CO); or
- the proposed financial assistance is approved by an ordinary resolution (s285 CO), and no court order is pending or has been made restraining the giving of the assistance on the application of shareholders holding at least 5% of the total voting rights or members representing at least 5% of the members of the company (ss286 to 288 CO).

Further, on the ***same day*** that the directors pass the resolution mentioned above, each director who voted in favour of the resolution shall make a solvency statement (i.e. a statement that each director has formed the opinion that immediately after the transaction there will be no ground on which the company could be found to be unable to pay its debts and the company will be able to pay its debts in full as they become due). Thereafter, the financial assistance shall be given no later than 12 months after the day on which the solvency statement is made.

More importantly, the CO provides that, where a company gives financial assistance in contravention of the CO, the financial assistance and any contract or transaction connected with it will not be invalidated solely because of that contravention (*s*276 CO). Although commentaries argue what is meant by the word “solely”, it seems that the rights of third parties, usually the lenders, are not affected by the prohibition on financial assistance. However, generally, lenders would not ignore any non-compliance with the CO and will require that the relevant parties obtain necessary approvals.

Corporate Authority

Companies must act in accordance with their constitutional documents (articles of association). Under the CO, a Hong Kong-incorporated company is required to have articles of association, but no longer memorandum of association (which traditionally contained a company’s objects clause) since amendments under the CO came into force on 3 March 2014. For existing companies, the provisions of its memorandum are considered to be provisions of its articles (s98(1) CO). If a company either elects not to have an objects clause or removes it, the company’s powers are unfettered: it will have the capacity, rights, powers and privileges of a natural person (s115(1) CO). However, if a company does state its objects in its articles (although it is not obliged to do so), it must not do any act which is not authorised by its articles (s116(1) CO).

If a company does an act (including a transfer of property to or by the company) in breach of any objects clause it may have in its articles or contrary to an express exclusion or modification in its articles, that act will not be invalid **only** because of the breach (s116(5) CO). There must be some other “negative factors” present (e.g. the third party was dealing with the company in bad faith or was actually aware that the act was in breach of the company’s articles) before the act will be invalid, as the breach is not then the only problem. s116(5) CO should be read in conjunction with s120 CO, which provides that a person is not to be regarded as having notice of the articles, return or resolution filed with the Companies Registry **merely** because they are available for inspection at the Companies Registry. The difficulty with both these sections is the inclusion of the words **“only”** (s116(5) CO) and **“merely”** (s120 CO). As these sections have not been tested by the Hong Kong courts, their exact effect is unclear. Presumably those acting in bad faith or who actually knew of a breach would not be protected by these provisions. But it is unclear about those who would in the normal course of their business carry out a company search to check on the capacity of their contractual counterparties, but for some reason omitted to do so. Possibly the failure to carry out a search or check which a reasonable person in the same position as the third party would have carried out (especially in

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suspicious circumstances) will be treated as a "negative factor" making the company's act invalid, as under the old law. Hence, lenders should always carry out company searches and checks to ensure that the proposed transaction is within the ambit of the company's objects clause (if any) and that the company in question and its directors have requisite powers to enter into the proposed transaction.

Corporate Benefit and Directors' Duties

Directors of a Hong Kong-incorporated company have a fiduciary duty to act in what they believe is for the commercial benefit of the company, and not just in the interests of the corporate group as a whole. Determining whether a director acted in the best interest of the company is a matter of fact and directors are advised to seek shareholders' approval in uncertain circumstances. This duty is particularly significant in relation to upstream guarantee, cross guarantee and third party security transactions. In order to negate potential shareholder claims that there was no corporate benefit, it is common to require the company to pass a shareholder resolution (in addition to a board resolution) confirming the transaction irrespective of whether the company would derive any commercial or other benefit (sufficient or otherwise) from the transaction.

Loans to Directors

Subject to a few exceptions (such as, transactions among group companies and a loan, quasi-loan and credit transaction of value not exceeding 5% of the net assets or called-up share capital of the company), a Hong Kong company cannot make loans to, or guarantee or provide security for the obligations of, its directors or persons connected to, or controlled by, the directors of such Hong Kong company, without prior shareholders' approval obtained in accordance with a prescribed procedure (in cases involving public companies, the approval of disinterested shareholders is needed).

Breach of this prohibition may affect the enforceability of the underlying loan agreement, guarantee or security document.

12. Are there any restrictions against providing security to support borrowings incurred for the purposes of acquiring shares: (i) of the company; (ii) of any company which directly/indirectly owns shares in the company; or (iii) in a related company?

Please refer to the "**Financial Assistance**" sub-section of our response to Question 11 above.

13. Can lenders in a syndicate appoint a trustee or agent to (i) hold security on the syndicate's behalf, (ii) enforce the syndicate's rights under the loan documentation and (iii) apply any enforcement proceeds to the claims of all lenders in the syndicate?

Yes, lenders in a syndicate can appoint a trustee or agent to (i) hold security on the syndicate's behalf, (ii) enforce the syndicate's rights under the loan documentation and (iii) apply any enforcement proceeds to the claims of all lenders in the syndicate.

14. If your jurisdiction does not recognise the role of an agent or trustee, are there any other ways to achieve the same effect and avoid individual lenders having to enforce their security separately?

Not applicable.

15. Does withholding tax arise on (i) payments of interest to domestic or foreign lenders, or (ii) the proceeds of enforcing security or claiming under a guarantee?

Under Hong Kong laws, there is no withholding tax on (i) payments of interest to domestic or foreign lenders or (ii) the proceeds of enforcing security or claiming under a guarantee.

16. If payments of interest to foreign lenders are generally subject to withholding tax, what is the standard rate and what is the minimum rate possible under double taxation treaties?

Not applicable.

17. Are there any other tax issues that foreign lenders should be aware of when lending into your jurisdiction?

Persons, including corporations, partnerships, trustees and bodies of persons, which carry on any trade,

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profession or business in Hong Kong, are chargeable to tax on all profits (excluding profits arising from the sale of capital assets) arising in or derived from Hong Kong from such trade, profession or business. The questions of whether a business is being carried on in Hong Kong and whether profits are derived from Hong Kong are largely questions of fact.

An offshore company can be considered to be carrying on business in Hong Kong through an agent, if that agent has authority to, and does, commit the company to legally binding contracts, whether or not decisions to do so are taken only by staff of the company located outside Hong Kong.

18. Are there any tax incentives available for foreign lenders lending into your jurisdiction?

As mentioned in question 15 above, no withholding tax will be imposed on interest payment to foreign lenders and proceeds received as a result of security enforcement.

Apart from that, Hong Kong has entered into separate double taxation agreements with various countries (for example, Austria, Canada, Italy, New Zealand etc.) to provide relief for double taxation. In respect of business profits, one of the common articles under the double taxation agreements is that profits of an enterprise are only taxable in the country in which the enterprise is resident, *unless* the enterprise carries on business in the other contracting country through a permanent establishment situated in such contracting country. In such case, the profits which are attributable to the permanent establishment of the enterprise will be taxed in such contracting country.

19. Is there a history in your jurisdiction of financing structures being challenged by tax authorities, and if so, can you give examples.

We are not aware of any such challenges.

20. Do the courts in your jurisdiction generally give effect to the choice of other laws (in particular, English law) to govern the terms of any agreement entered into by a company incorporated in your jurisdiction?

Hong Kong courts usually recognise and apply the parties' choice of law (including English law) subject to certain exceptions, for example:

- When the choice of foreign law is not bona fide.
- When the choice of foreign law contradicts public policy.

However, Hong Kong courts will apply local law in relation to procedural rules, revenue matters, penalties or confiscation of property.

21. Do the courts in your jurisdiction generally enforce the judgments of courts in other jurisdictions and is your country a member of The Convention on the Recognition and Enforcement of Foreign Arbitral Awards?

There are three main ways through which foreign judgments can be enforced in Hong Kong.

1. Subject to certain conditions and restrictions, a monetary judgment from the superior courts of certain specific jurisdictions, including, Australia, Singapore, France, Germany, etc. (but not English or US courts) may be enforced in Hong Kong by registration in the High Court of Hong Kong within six years after the date of the judgment pursuant to the Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap 319 of the Laws of Hong Kong) (the "**JRE Ordinance**").

2. Any monetary judgment from any jurisdiction (other than mainland China) that is not within the scope of the JRE Ordinance (including a judgment from an English or US court) can be enforced in Hong Kong at common law within the jurisdiction of the High Court of Hong Kong by an action or counterclaim for the amount due under it if the judgment is:

(a) for a debt or definite sum of money (not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty); and

(b) final and conclusive.

Again, there are certain conditions and restrictions for such enforcement, including the original judgment was not obtained by fraud, its enforcement or recognition would not be contrary to public policy, etc.

3. Hong Kong and mainland China have established a legal mechanism for mutual recognition and enforcement of judgments. Under the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the

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Mainland and of the Hong Kong Special Administrative Region Pursuant to the Choice of Court Agreements between Parties Concerned signed on 14 July 2006 (and amended on 29 February 2008) (the "**2006 Arrangement**"), a monetary judgment in a civil or commercial case that is obtained in mainland China (where parties to the contract had agreed in writing to designate a people's court of mainland China as having exclusive jurisdiction for resolving a dispute arising from such contract) may be recognised and enforced in Hong Kong, and *vice versa*.

A more comprehensive mechanism for mutual recognition and enforcement of judgments is about to take effect – the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region signed between the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on 18 January 2019 (the "**2019 Arrangement**"). The 2019 Arrangement will extend to cover monetary and non-monetary judgments in civil and commercial matters under mainland China and Hong Kong laws. The 2019 Arrangement will be implemented in Hong Kong by way of local legislation and will take effect after both places have implemented the regime. Before the commencement date, the 2006 Arrangement will continue to apply.

Also, Hong Kong is a member of The Convention of Recognition and Enforcement of Foreign Arbitral Awards (the "**New York Arbitration Convention**") by way of PRC's accession.

22. What (briefly) is the insolvency process in your jurisdiction?

The main types of insolvency proceedings to which a company may become subject under Hong Kong law are receivership, compulsory liquidation and creditors' voluntary liquidations. In particular, lenders may consider the appointment of a receiver (where available) as an option for enforcing their security (although such an appointment can occur outside insolvency). In addition, creditors' schemes of arrangement may be proposed (which may be propounded outside insolvency), either as a standalone compromise or arrangement or in conjunction with formal insolvency proceedings.

Receivership

A creditor may appoint a receiver either by making an application to the court or, if the contractual terms of the relevant security document grant a right of appointment to the creditor, pursuant to such contractual terms, so as to safeguard its interests. The appointment must be in writing and, in the case of real estate, be registered with the Hong Kong Land Registry. In the case of a corporate debtor, the Hong Kong Companies Registry must be notified of the details of the appointment within seven days of the appointment. Although the receiver is usually appointed by the lender, it is always provided in the underlying security documents that the receiver is the debtor's agent. In order to avoid incurring any liability, the lender should not interfere with, or direct, the receiver's activities. The receiver's powers are generally regulated by the underlying security documents and normally include powers to take possession of and to sell the property.

Compulsory Liquidation

Compulsory liquidation (or winding-up) involves the appointment by the court of a liquidator, typically upon the application of a creditor, to wind up the company, realise its assets and distribute them to creditors according to their ranking. A winding-up petition is not usually favoured by secured lenders if other more convenient enforcement options are available.

Following the presentation of a winding-up petition and before the winding-up order is made, the court can appoint a provisional liquidator to safeguard the assets of the company where they are determined by the court to be in jeopardy and/or at risk of dissipation.

A liquidator will be subsequently appointed by the court, having regard to the resolutions passed at the first creditors' meeting and the first meeting of contributories (in practice, the contributories are typically the shareholders).

The liquidator controls the liquidation process under the supervision of the court. A creditors' committee (the committee of inspection) may be appointed to work with the liquidator in relation to certain matters. For example, the court or the committee of inspection must approve compromises with creditors and the commencement of litigation. The powers of the company's directors cease when the winding-up order is made.

Secured lenders can enforce their security whilst the company is in liquidation. Although there is an automatic stay of all actions and proceedings against the company, in case court proceedings have to be commenced for a secured lender to enforce its security, it can be anticipated that the liquidator will consent to, or the court will allow, the lifting of the stay.

Creditors' Voluntary Liquidation

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A creditors' voluntary liquidation may be commenced by the passing of a members' special resolution that the company be wound up voluntarily. Such voluntary liquidation would proceed as a creditors' (rather than members') voluntary liquidation if a certificate of solvency to the effect that the company is able to pay its debts in full within the 12 months from the commencement of the winding-up cannot be issued. A meeting of the creditors of the company must be summoned for a date not later than 14 days after the meeting of the company at which the members' resolution for voluntary winding up is to be proposed. Notice of the creditors' meeting must be given to creditors and advertised in appropriate newspapers in the prescribed manner. A statement of affairs of the company must be tabled at the relevant meeting of creditors and any nomination of a liquidator by the meeting of creditors will prevail over any contrary nomination made by the shareholders.

The directors' powers in relation to the company cease during the period of the liquidator's appointment, except where the committee of inspection, if there is one, or otherwise the creditors, agree that they can continue for limited purposes (i.e. as necessary for enabling the directors to comply with the relevant provision of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("**CWUMPO**") or with the court's sanction). Secured lenders can enforce their security whilst the company is in liquidation. While there is no moratorium on proceedings against the company by a secured creditor, the court has a discretion to stay legal proceedings on the application of a creditor, contributory or the liquidator.

There exists an alternative procedure that allows the directors to commence a voluntary winding-up in circumstances where the company cannot by reason of its liabilities continue its business and it is not reasonably practicable to commence the winding-up in any other way. The directors would need to file a winding-up statement with the Hong Kong Companies Registry and meetings of members and creditors would need to be summoned within 28 days of such filing. Misuse of this procedure carries a penalty, including a fine and imprisonment.

Creditors' Scheme of Arrangement

A creditors' scheme of arrangement is a statutory, binding compromise reached between a company and its creditors (or one or more classes of them). As noted above, it is not an insolvency procedure. A creditors' scheme of arrangement must be (a) approved by a majority in number representing at least 75% in value of the (relevant class of) creditors present and voting, in person or by proxy and (b) sanctioned by the court. The rights of secured and preferred creditors cannot be affected without their consent and thus, secured creditors may enforce their security prior to the scheme becoming effective or otherwise expect to stand outside the scheme. However, once a scheme of arrangement has been sanctioned by the relevant classes of creditors and the court, it will bind all such creditors and may, depending on its terms and subject to approval by its secured creditors, restrict the rights of secured creditors.

Note that Hong Kong does not currently have any statutory corporate rescue regime or debtor protection insolvency procedure, such as the UK administration order or Chapter 11 of the US Bankruptcy Code, so the rights of security holders are generally unaffected by a liquidation or a scheme of arrangement, because neither a liquidation nor a scheme of arrangement (until implemented) will necessarily preclude security enforcement.

The Hong Kong government is currently seeking to finalise a bill to introduce, among other things, a new statutory corporate rescue procedure ("**CRP**") and insolvency trading provisions in Hong Kong.

The Financial Services and the Treasury Bureau ("**Bureau**") consulted various stakeholders in Hong Kong and the Bureau introduced the "Legislative Proposal of the Companies (Corporate Rescue) Bill" ("**Proposals**") before the Panel of Financial Affairs in the Legislative Council in November 2020. The Proposals aim to provide an option for distressed companies to rehabilitate their businesses and help creditors to achieve a better return than in an immediate liquidation.

Under the Proposals, the members or the directors of the company would be able to pass a resolution to appoint an independent third-party to be the provisional supervisor ("**PS**"). If the company has already entered into liquidation, the provisional liquidator or liquidator would be able to appoint a PS with the leave of the court, provided that they are of the view that the company is insolvent or likely to become insolvent at some future time and provisional supervision is reasonably likely to achieve the statutory objects. At the end of the provisional supervision, a company would be able to enter into a voluntary arrangement, being a rescue plan its PS has prepared.

Creditors holding security over all, or substantially the whole, of a company's property may be entitled to oppose the nomination of the PS, although greater clarity on this aspect may be needed.

Once a company is under provisional supervision, there would be a moratorium on civil proceedings and actions

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against the company and its property, and generally no application or resolution for the winding-up of the company could be made, although there would be exceptions.

The Proposals also noted that the moratorium would not operate to terminate automatically contracts entered into by the company except that contractual ipso facto clauses (that is, broadly, a provision in an agreement which allows its termination due to the insolvency or winding-up of a party) would continue to be enforceable.

The bill is expected to be introduced into the Legislative Council in the first half of 2021, although a number of aspects may need further clarification.

23. What impact does the insolvency process have on the ability of a lender to enforce its rights as a secured party over the security?

The commencement of insolvency procedures generally does not affect a secured creditor's rights to enforce its security, unless the security transaction is voidable or payments can be clawed back by the liquidator (*see Question 24 below*).

24. Please comment on transactions voidable upon insolvency.

Transactions at an Undervalue (natural person) (s.49 Bankruptcy Ordinance (Cap. 6) ("BO"))

Where a debtor, being a natural person, is adjudged bankrupt by the Hong Kong courts and has entered into a transaction with any person at an undervalue within five years before the presentation of the bankruptcy petition against him or her which, as a matter of Hong Kong law, constitutes a transaction at an undervalue, it may be set aside on application to the Hong Kong courts by the debtor's trustee in bankruptcy. A debtor, being a natural person, enters into a transaction with a person at an undervalue if:

- that debtor makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for that debtor to receive no consideration;
- that debtor enters into a transaction with that person in consideration of marriage; or
- that debtor enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by that debtor.

Transaction at an Undervalue (company) (ss. 265D and 265E CWUMPO)

Where a debtor, being a company, is wound up by the Hong Kong courts and has entered into a transaction with any person at an undervalue within five years before the commencement of the winding-up which, as a matter of Hong Kong law, constitutes a transaction at an undervalue, it may be set aside on application to the Hong Kong courts by the liquidator. A debtor company enters into a transaction with a person at an undervalue if:-

(a) that debtor company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for that debtor company to receive no consideration; or

(b) that debtor company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by that debtor company.

Unfair Preferences (natural person) (s.50 BO)

A bankruptcy trustee may apply to the Hong Kong courts to set aside a transaction where a debtor is adjudged bankrupt and has given an unfair preference to any person within six months before the presentation of the bankruptcy petition against him or her. A debtor (whether a natural person or a company) gives an unfair preference to a person if:

(a) that person is one of the debtor's creditors or a surety or guarantor for any of the debtor's debts or other liabilities; and

(b) the debtor does anything or suffers anything to be done which has the effect of putting that person into a position which, if the debtor is declared bankrupt, will be better than the position that person would have been in if that thing had not been done.

In respect of an unfair preference given to an associate of a debtor who is a natural person and who is an associate otherwise than by reason only of being the debtor's employee, the relevant period is extended from six months to two years. Pursuant to s51B of the BO, an associate of a debtor broadly includes, among others:

(i) that debtor's spouse, or a relative, or the spouse of a relative of that debtor or that debtor's spouse;

(ii) a person with whom that debtor is in partnership, and

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the spouse or a relative of the debtor with whom the person is in partnership;

(iii) a person whom that debtor employs or is employed by;

(iv) a trustee of a trust of which the beneficiaries include, or the terms of the trust confer a power that may be exercised for the benefit of, that debtor or an associate of that debtor; and

(v) a company of which that debtor has control or if that debtor and persons who are the debtor’s associates together have control of it.

Unfair Preferences (company) (s.266-266B CWUMPO)

A liquidator may apply to the Hong Kong courts to set aside a transaction where a company which is wound up has given an unfair preference to a person within six months before the commencement of its winding-up proceedings A debtor gives an unfair preference to a person if:

(a) that person is one of the company’s creditors or a surety or guarantor for any of the company’s debts or other liabilities; and

(b) the company does anything or suffers anything to be done which has the effect of putting that person into a position which, if the company is going into insolvent liquidation (that is, goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding-up), is better than the position it would have been in if that thing had not been done,

and the company was influenced, in deciding to give that unfair preference, by a desire to procure the effect under paragraph (b) above.

In respect of an unfair preference given to a connected person of the company who is a connected person otherwise than by reason only of being the company’s employee, the relevant period is extended from six months to two years and there exists a rebuttable presumption that the company had the requisite desire to prefer. Pursuant to ss265B and 265C of CWUMPO, a person is connected with a company if he is an associate of a director or a shadow director of the company or an associate of the company.

The definition of “associate” under CWUMPO is broader than under the BO. A person is an associate of another person if that person:

(i) is a spouse or cohabitant of that other person, or a relative of that other person, or of that spouse or cohabitant, or a spouse or cohabitant of that relative;

(ii) is in partnership that other person; or a spouse, cohabitant or relative of that other person;

(iii) employs or is employed by that other person.

In addition, a person in the capacity as trustee of a trust is an associate of another person if the beneficiaries include, or the terms of the trust confer a power that may be exercised for the benefit of, that other person or an associate of that other person.

A person is an associate of a company if that person is a director, shadow director or other officer of the company. A company is an associate of another company if (i) the same person has control of both; (ii) a person controls one company and his associates control the other company; or (iii) a group of two or more persons controls each company, and both groups consist of the same persons or associates of such persons. A company is an associate of another person if that person has control of the company or that person and persons who are associates of that person together have control of the company.

Avoidance of Floating Charges (ss.267 and 267A CWUMPO)

To the extent a security document creates a floating charge over the assets and undertakings of a company, the floating charge may be partially or wholly held to be invalid if it is created at a time in the period of 12 months ending with the day on which the winding up of the company commences and the company is at that time, or becomes in consequence of the transaction under which the charge is created, unable to pay its debts (within the meaning of s178 of the CWUMPO), except to the extent of (i) the amount of any new money paid to, or at the direction of, the chargor at the time of, or subsequent to, the creation of the floating charge; or (ii) any property or services supplied to the chargor at the same time as, or after, the creation of the floating charge; and, in each case, interest payable under the terms of the charge or the underlying transaction document at the lesser of the rate specified in the charge or transaction document and 12 per cent. per annum.

The relevant period is extended from 12 months to 2 years if the floating charge is created in favour of a person connected with the company as defined in ss265A(3), 265B and 265C of CWUMPO. Extortionate Credit Transactions (s.264B CWUMPO)

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A liquidator may challenge a transaction where credit was provided to the insolvent company on the grounds that it was extortionate. The liquidator or administrator would need to establish that:

● the transaction was entered into in a period of three years ending with the day on which the company went into liquidation; and

● having regard to the risk accepted by the credit-provider, the terms of the transaction were such as to require grossly exorbitant payments to be made in respect of the provision of the credit or it otherwise grossly contravened ordinary principles of fair dealing. There is a presumption that the transaction was extortionate, unless the defending credit-provider proves the contrary.

Fraudulent Conveyance (s.60 Conveyancing and Property Ordinance (Cap. 219))

Any disposition of property made with intent to defraud creditors is voidable on the application of any person prejudiced by the disposition.

Onerous Property (s.268 CWUMPO)

A liquidator may, with leave of the court, disclaim onerous property held by the insolvent company (for example, land burdened with onerous covenants).

25. Is set off recognised on insolvency?

Insolvency set-off is mandatorily applied as at the date of the relevant winding up order. The conditions of provability and mutuality are important features for the application of insolvency set-off.

As regards mutuality, broadly speaking prior to the insolvency (i) there should be only two debtor-creditors and (ii) each claimant is both beneficial owner of the claim owed to it and personally liable on the claim owed by it. Trust arrangements, for example, may displace mutuality.

If a creditor has both secured and unsecured claims, the creditor must, broadly, elect to either:

- Surrender his security and prove in the liquidation; or
- Set-off only against the unsecured claims.

26. Can you comment generally on the success of foreign creditors in enforcing their security and successfully recovering their outstandings on insolvency?

Neither the laws of Hong Kong nor its courts discriminate or are otherwise biased against foreign secured creditors. The success of secured creditors in enforcing their security depends on their ability to trace and obtain control of the asset and the asset's disposal value. The courts will provide foreign creditors the same assistance they extend to local creditors.

27. Are there any impending reforms in your jurisdiction which will make lending into your jurisdiction easier or harder for foreign lenders?

Except the proposed implementation of the statutory CRP mentioned in question 22 above, there is currently no proposal for legal reform which would significantly affect the areas covered in this questionnaire.

28. What proportion of the lending provided to companies consists of traditional bank debt versus alternative credit providers (including credit funds) and/or capital markets, and do you see any trends emerging in your jurisdiction?

Given the size of local deposit that the banks can utilise and the low interest rate, the loan market is still dominated by traditional bank borrowings, especially in the case of plain vanilla financing. Credit funds are more active in the event-driven financing, e.g. leverage financing or project financing. Given the ability to obtain a large amount of proceeds in a short period of time, some companies (in particular, PRC real estate companies) will also tap the bond market for funds on a regular basis.

29. Please comment on external factors causing changes to the drafting of secured lending documentation and the structuring of such deals such as (i) Brexit (ii) LIBOR transition and/or (iii) COVID 19

(i) Brexit may impact Hong Kong law governed documentation in the case that there are UK incorporated lenders or obligors involved. Provisions that used to refer to EU law (e.g. bail-in or sanctions provisions) would have to instead refer to its local UK counterpart instead.

(ii) The Hong Kong Monetary Authority has issued LIBOR

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transition milestones, whereby authorised institutions should include adequate fall-back provisions in all newly issued LIBOR-linked agreements that will mature after 2021. Therefore, as a minimum, lenders are ensuring that their facility agreements have LIBOR fall-back provisions. These LIBOR fall-back provisions may take form of the "replacement of screen rate" provisions in APLMA facility agreements. Some lenders may choose to incorporate rate switch mechanisms for transitioning LIBOR referenced loans to hardwired risk free rates by adopting the discussion draft language issued by the APLMA in December 2020.

(iii) Some strong borrowers may request carve-outs to certain of their representations and warranties and undertakings to the extent affected by COVID 19 and in the case of project loans, some borrowers may request for COVID 19 lockdown care-outs to allow for delays in progress of the project. More commonly, COVID 19 affects provision of original documents, which may in turn affect condition precedent or subsequent requirements or the mode of signing adopted by the parties in the documentation (e.g. the use of electronic signing). But there is not an established market position on these issues and would have to be considered by the lenders on a case-by-case basis.

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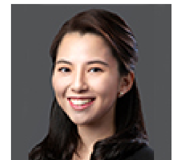

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