

Hong Kong

Jeffrey H Chen, Mayer Brown LLP and Kingsley Ong, JSM

www.practicallaw.com/4-501-2411

MARKET AND LEGAL REGIME

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

- How active and/or developed is the market and what notable transactions and new structures have taken place recently?
- To what extent have central bank liquidity schemes assisted the securitisation market in your jurisdiction? Were retained securitisations common in the last 12 months?
- Is securitisation particularly concentrated in certain industry sectors?

Despite having a developed legal framework to support securitisation, Hong Kong has a low level of securitisation activity. This is generally due to the ready availability of other more conventional types of funding at inexpensive rates. The most significant securitisation activity over the past decade has been the domestic issuance of residential mortgage-backed securities (RMBSs) by the Hong Kong Mortgage Corporation (HKMC), creating a robust secondary mortgage market.

Over the past 12 months, market activity has remained relatively inactive due to both:

- The global financial crisis.
- Recent bad publicity in the Hong Kong media relating to retail structured products following the global insolvency of Lehman Brothers.

The Hong Kong Monetary Authority (HKMA), the principal financial regulator, has not formally introduced any liquidity schemes to assist the securitisation market. However, the HKMA actively supports financial markets in other ways, such as the guaranteeing of bank deposits.

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

- What are the main laws governing securitisations?
- Is there a regulatory authority?

There are no securitisation-specific laws or regulatory authorities 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). In *HKSAR v Ma Wai-kwan and others* (29 July 1997), the Hong Kong Court of Appeal decided that the common law and rules of equity of England which applied in Hong Kong on 30 June 1997 continue to apply in the HKSAR, subject to their independent development, both (*Article 8, Basic Law of the Hong Kong Special Administrative Region (HKSAR)*):

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

Some of these laws and rules affect securitisations.

REASONS FOR DOING A SECURITISATION

3. Which of the reasons for doing a securitisation, as set out in the Model Guide, usually apply in your jurisdiction? In particular, how are the reasons for doing a securitisation in your jurisdiction affected by:

- Accounting practices in your jurisdiction, such as application of the International Financial Reporting Standards (IFRS)?
- National or supra-national rules concerning capital adequacy (such as the Basel International Convergence of Capital Measurement and Capital Standards: a Revised Framework (Basel II Accord) or the Capital Requirements Directive)? What authority in your jurisdiction regulates capital adequacy requirements?

Usual reasons for securitisation

The usual reasons for securitisation are the same as those set out in the Model Guide (*see Model Guide, Reasons for doing a securitisation*).

Accounting practices

The mandatory sources of generally accepted accounting principles (GAAP) are:

- Companies Ordinance (Cap. 32) for companies incorporated in Hong Kong.
- The Hong Kong Financial Reporting Standards (HKFRS), which are fully harmonised with the IFRS.
- The accounting and disclosure requirements of the Hong Kong Stock Exchange for companies listed on its main board and on its growth enterprise market.

Balance sheet benefits are now less of an incentive for originators and sponsors subject to IFRS. This is because it is increasingly difficult to justify not consolidating or recognising the accounting effects on a securitisation SPV in the originator's or sponsor's balance sheet.

Capital adequacy

Hong Kong has implemented Basel II under the:

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

The HKMA regulates capital adequacy requirements.

THE SPECIAL PURPOSE VEHICLE (SPV)

Establishing the SPV

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

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

SPVs typically take the form of a limited liability company. One or more persons can form a company by subscribing to a memorandum of association and complying with the relevant registration requirements (*section 4, Companies Ordinance (Cap. 32)*).

A duly incorporated company under the Companies Ordinance is treated as a separate legal entity. It has the capacity, rights, powers and privileges of a natural person (*section 5A, Companies Ordinance (Cap. 32)*).

A company is legally owned by its members (that is, shareholders in the case of companies limited by shares). In relation to SPVs, ultimate beneficial ownership is usually with a charitable trust. There is no prescribed minimum share capital. However, for practical purposes, this is not usually less than HK\$1,000 (about US\$130) or a foreign currency equivalent. There is a capital duty of 0.1% payable on the authorised share capital (subject to a cap of HK\$30,000 (about US\$3,870)).

There are no laws or regulatory requirements specifically applying to SPVs (*see Question 2*).

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

SPVs can be established in Hong Kong or offshore. If established offshore, it is usually for tax reasons. Typical offshore jurisdictions

include the Cayman Islands, British Virgin Islands and other low tax jurisdictions.

A foreign company intending to conduct business in Hong Kong must register as a non-Hong Kong company with the Hong Kong Companies Registry within one month of establishing a place of business in Hong Kong. The tax rate on profit derived in Hong Kong is the same for Hong Kong and foreign companies.

Ensuring the SPV is insolvency remote

6. Is it possible to make the SPV insolvency remote in your jurisdiction? If so, how is this usually achieved?

It is possible to make the SPV insolvency remote through a combination of methods, including:

- Placing restrictions to prevent the SPV incurring liabilities outside the scope of the relevant transaction.
- Properly pre-defining cash flows and subordination.
- Ensuring that all the SPV's potential creditors covenant to both:
 - limited recourse (that is, limiting creditors' recourse to available funds);
 - non-petition (that is, prohibiting any creditor from taking legal action or commencing insolvency proceedings against the SPV).
- Putting in place adequate liquidity, reserve and hedging facilities.
- Incorporating the SPV in a tax neutral jurisdiction.

Ensuring the SPV is treated separately from the originator

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

There is no general doctrine of substantive consolidation (that is, where assets of a separate legal entity such as an SPV can be treated as those of the originator and used to satisfy the originator's liabilities). Only in very limited circumstances is the separate legal personality of a company ignored (for example, in the case of fraud).

THE SECURITIES

Issuing the securities

8. Are the securities issued by the SPV usually publicly or privately issued?

The securities can be privately or publicly issued, depending on the transaction's individual circumstances.

9. If the securities are publicly issued:

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

Securities can be issued on the Hong Kong Stock Exchange or a regulated foreign exchange, depending on investor requirements and preferences (see *Question 8*).

When listing asset-backed securities on the Hong Kong Stock Exchange, the relevant rules are contained in the following Chapters of the Hong Kong Listing Rules:

- **Chapter 29.** This concerns tap issues, debt issuance programmes and asset-backed securities.
- **Chapter 37.** This concerns selectively marketed securities.

Rules 37.24 and 37.25 of the Hong Kong Listing Rules set out the documentary requirements for listing, including, among other things:

- A prospectus.
- Formal notice.
- A trust deed.
- A listing checklist.
- A listing fee.

The choice of listing on a particular exchange depends on:

- Investor requirements and preferences.
- The approval process.
- Ease of listing.

Constituting the securities

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

The trust concept is recognised. The securities issued by an SPV are usually constituted under a trust deed which sets out both the:

- Terms and conditions of the issue.
- Rights in the securities held by the trustee.

TRANSFERRING THE RECEIVABLES

Classes of receivables

11. What classes of receivables are usually securitised in your jurisdiction? Please explain any particular reasons (for example, the strength of the origination market) why such receivables are usually securitised and the progress of the market in securitising new classes of receivables.

A variety of receivables have been securitised, including:

- RMBSs.
- Future bridge toll receivables.
- Trade receivables.

Hong Kong's legal system is largely based on English law (see *Question 2*), and Hong Kong has a developed legal framework to accommodate almost any type of receivables securitisation that has been done in other common law jurisdictions.

The transfer of the receivables from the originator to the SPV

12. How are the receivables usually transferred from the originator to the SPV (for example, assignment, novation, sub-participation, declaration of trust)? How is the transfer perfected? Are there any rules, requirements or exemptions that apply specifically to transferring receivables in a securitisation transaction?

Receivables are usually sold by assignment. A sale of receivables by assignment requires an agreement, in writing or otherwise, between the assignor and the assignee with both:

- Valuable consideration.
- A clear intention to assign.

An agreement for the assignment of future receivables usually takes effect when the receivables come into existence.

There are two types of assignment:

- **Legal assignment.** The assignment is legal if the following procedural requirements are satisfied (*section 9, Law Amendment and Reform (Consolidation) Ordinance (Cap. 23)*):
 - it is absolute;
 - it is in writing by the hand of the assignor;
 - it does not purport to be by way of a charge only;
 - notice in writing of the assignment is given to the debtor.
- **Equitable assignment.** For commercial and practical reasons, originators of receivables usually prefer to avoid giving notice to debtors. Therefore, transfer of ownership of receivables is commonly affected by equitable assignment, without notice of the assignment being given to the debtor.

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

For an equitable assignment to be perfected (and become a legal assignment), it must satisfy the same requirements as for legal assignments (*see above*). This usually means that written notice must be given to the debtor. Typically, for commercial and practical reasons, parties agree not to perfect the equitable assignment (and therefore not issue any notice of assignment to the debtor) unless certain default events occur.

Until an equitable assignment is perfected (and becomes a legal assignment), among other things:

- The debtor can validly discharge its debt by paying the originator.
- The debtor and the originator can amend the underlying agreement.
- The debtor can raise against the purchaser all the defences it could have raised against the originator (including set-off).
- A subsequent assignee or encumbrancer of the originator's receivables takes priority over the purchaser if the assignee or encumbrancer both:
 - did not have notice of the assignment of the originator's receivables at the time the subsequent assignment or encumbrance is granted;
 - is the first to give notice of its assignment or encumbrance to the relevant debtor.

The purchaser can only sue the debtor in the purchaser's own name if the assignment is a legal assignment (that is, the assignment fulfils the criteria for a legal assignment under section 9 of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23) (*see above*)).

Priority between competing assignments of receivables is determined by the order in which notice of the assignments is given to the debtor, rather than the order of the assignments themselves (except where a 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 equitable assignment is vulnerable.

Receivables can also be sold by:

- Novation, which requires the agreement of all parties to the underlying contract and the purchaser.
- A declaration of trust.
- Sub-participation, although this method does not typically result in a "true sale" transfer of title (*see Question 16*).

There are no rules, requirements or exemptions specific to transferring receivables in a securitisation transaction.

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

Hong Kong's legal system is largely based on English law (*see Question 2*), and Hong Kong has a developed legal framework to accommodate almost any type of receivables securitisation that has been done in other common law jurisdictions.

An assignment for valuable consideration of future receivables that are adequately identified is treated as an equitable agreement to assign (future receivables cannot be legally assigned). The agreement assigns the receivables as soon as they come into existence (although notice is still required to perfect the assignment). However, on the originator's insolvency, an agreement to assign future receivables only automatically transfers receivables as they arise where there is nothing further to be done by the originator to earn the receivables.

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

If there are no restrictions on transferring the underlying security, the underlying security is usually assigned to the SPV or security agent when the receivables are sold. The obligor's consent may be required if there are any contractual restrictions or prohibitions on the originator's ability to transfer the underlying security.

Additional formalities may be required depending on the nature of the related security being transferred. For example, an equitable assignment of interests relating to land must be in writing (*section 5, Conveyancing and Property Ordinance (Cap. 219)*). The transfer of mortgages requires registration with the Hong Kong Land Registry. No *ad valorem* stamp duty is generally payable on transfer of mortgages. However, it is recommended practice to confirm this with the Hong Kong Collector of Stamp Revenue through an adjudication for stamp duty. The adjudication fee is HK\$50 (about US\$6) per document.

Prohibitions on transfer

15. Are there any prohibitions on transferring the receivables or other issues restricting the transfer? For example, is a negative pledge enforceable, or are there any legislative provisions that affect the transfer of receivables (such as consumer or data protection rules)?

If a receivables contract is silent on the right to assign, the creditor can generally sell the receivable without the consent of the debtor, except in certain limited circumstances (for example, where the assignment is prohibited by public policy).

Contractual restrictions

Contractual provisions restricting or prohibiting transfers are generally enforceable. Where there is a contractual restriction, the underlying obligor's consent is required to properly effect the transfer (otherwise, the transfer is ineffective against the obligor).

Additionally, if the purchaser is aware of the anti-assignment provisions in a receivables contract but proceeds with the assignment, the purchaser could be liable under the tort of inducing a breach of contract. However, the obligor is unlikely to be adversely affected because the assignment is ineffective against the obligor.

Legislative restrictions

Data protection. The Personal Data (Privacy) Ordinance (Cap. 486) controls the processing of information about living individuals. The Personal Data (Privacy) Ordinance does not cover information about enterprises. Any person who collects or uses personal information about an individual, from which it is possible to identify the individual, is deemed a data user. An SPV acquiring receivables which continue to be serviced by the originator is likely to be a data user and must comply with the data protection principles set out in Schedule 1 of the Personal Data (Privacy) Ordinance. Individuals can request, among other things:

- Access to their personal data held by data controllers.
- That incorrect data is corrected.

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

Consumer protection. There is limited consumer protection legislation applying to the purchase of receivables:

- **Section 25(3) of the Money Lenders Ordinance (Cap. 163).** This provides that any agreement is presumed to be extortionate (and therefore unenforceable) if it is for the repayment of a loan, or payment of interest on a loan, with an effective rate of interest exceeding 48% per year.
- **Section 24 of the Money Lenders Ordinance (Cap. 163).** This provides that where the interest rate exceeds 60% per year, the following are unenforceable:
 - the agreement to repay principal or interest on the loan;
 - any security given in respect of the agreement or loan.

Breach of section 24 of the Money Lenders Ordinance is a criminal offence carrying a maximum penalty of both:

- a HK\$5 million (about US\$645,070) fine; and
- ten years' imprisonment.

However, this section does not apply to:

- any loan made to a company that has a paid up share capital of at least HK\$1 million (US\$129,010);
- authorised institutions within the meaning of the Banking Ordinance (Cap. 155).
- **The Unconscionable Contracts Ordinance (Cap. 458).** This provides that an "unconscionable" term in an agreement with a consumer may be partially or wholly unenforceable.
- **The Supply of Services (Implied Terms) Ordinance (Cap. 457).** This imposes certain implied terms on suppliers of services to consumers.
- **The Consumer Council Ordinance (Cap. 216).** This establishes the Consumer Council, where consumers can lodge complaints against suppliers of goods and services.

- **The Control of Exemption Clauses Ordinance (Cap. 71).** This restricts the ability of a party to limit its liability, including contractual liability, under certain circumstances (for example, liability for death or personal injury caused by negligence, and failure to satisfy the reasonableness test under the Ordinance).
- **The Code of Banking Practice.** Where a bank purchaser is an authorised institution within the meaning of the Banking Ordinance (Cap. 155), it must comply with the Code of Banking Practice when dealing with private individuals.

Avoiding the transfer being re-characterised

16. Is there a risk that a transfer of title to the receivables will be re-characterised as a loan with security? If so, can this risk be avoided and/or minimised?

To be perfected and treated as an insolvency safe true sale, a sale of receivables must both:

- Avoid being classed as a "sham" transaction or re-characterised as a secured loan.
- Not be vulnerable on insolvency (*see Question 17*).

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

- In a sale transaction, the seller cannot retrieve the subject matter of the sale by returning to the purchaser the money that has passed between them. However, in the case of a mortgage or charge the mortgagor can, until he has been foreclosed, retrieve the subject matter of the mortgage or charge by returning to the mortgagee the money that has passed between them.
- If the purchaser sells the subject matter and realises a profit, he need not account to the seller for the profit. However, if the mortgagee realises the subject matter of the mortgage for a sum more than sufficient to repay him (with interest and costs), he must account to the mortgagor for the surplus.
- If the purchaser resells the purchased property at a price which is insufficient to recover the money that he paid to the seller, he cannot recover the balance from the seller. However, if the mortgagee realises the mortgage property for a sum that is insufficient to recover the money that he has paid to the mortgagor (with interest and costs), the mortgagee can usually recover from the mortgagor the balance of the money.

The following considerations are relevant to transfers in typical securitisation transactions:

- An obligation to repurchase assets that are in breach of warranties does not contravene the requirement that the originator be denied the right to reacquire the property, provided the obligation is seen as a remedy for breach of warranty (rather than a method of transferring loss or profit). Therefore, the warranty must relate to the state of the asset on sale rather than its subsequent performance.

- The fact that the purchaser need not account to the originator for profit on the sale of the property should not preclude profit extraction techniques (see *Question 24*) used in securitisations.
- The requirement that the originator need not make up any shortfall if the property is sold at a loss should not preclude credit enhancements that the originator may give in securitisations.
- The entry by the originator into derivative transactions with the purchaser to hedge the purchaser's interest rate risks should not prevent a true sale.
- The originator retaining control of collections as servicer or collection agent for the purchaser (which is common in securitisation) should not prevent a true sale.

Ensuring the transfer cannot be unwound if the originator becomes insolvent

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

Subject to the discussions below, the insolvency of the originator does not affect the rights of the purchaser in a true sale of existing receivables. In a true sale, the purchaser can collect, transfer or otherwise exercise ownership rights over receivables acquired even if the originator is subject to insolvency proceedings.

An agreement to assign future receivables operates to transfer those receivables when they come into existence. However, on the insolvency of the originator, if there are any actions required by the originator under the agreement before the receivables are transferred, the purchaser cannot rely on the originator continuing to carry out those actions (see *Question 13*).

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 a registrable security listed in section 80(2) of the Companies Ordinance (Cap. 32) is void against a liquidator and other creditors of the originator if it is not registered within five weeks after its creation (section 80(1), *Companies Ordinance (Cap. 32)*).

Unfair preference. Any of the following may be invalid if it is made or done by or against a company within six months (or in the case of an unfair preference to an associate, two years) (that is, the suspect period) before the commencement of its winding up, if it is an unfair preference:

- Conveyance.
- Mortgage.
- Delivery of goods.
- Payment.
- Execution.
- Other acts relating to property.

A court will not order a transaction that took place during the suspect period to be rescinded or reversed, if both the (section 266B, *Companies Ordinance (Cap. 32)*):

- Transaction was entered into by the company in good faith and not to defraud its creditors.
- Terms of the transaction are bona fide arm's length commercial terms entered into for bona fide commercial reasons.

No purchase, made bona fide and without fraud, of any interest in property of any kind in Hong Kong will be open or set aside merely on the ground of undervalue (section 59, *Conveyancing and Property Ordinance (Cap. 219)*).

Fraudulent disposition. Every disposition of property made with intent to defraud creditors is voidable at the request of any person prejudiced by the disposition (section 60(1), *Conveyancing and Property Ordinance (Cap. 219)*).

Fraudulent trading. Any person who carries on any business of a company with intention to defraud creditors is personally liable for the company's liabilities (section 275, *Companies Ordinance (Cap. 32)*). The court has a wide discretion as to the nature of the relief that can be granted. It generally awards damages, but it can order the unwinding of the transaction.

Establishing the applicable law

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

The parties can choose which law governs the contract, providing the choice is:

- Bona fide.
- Legal.
- Not against public policy.

However, even if a foreign law is chosen, the Hong Kong courts still apply mandatory Hong Kong laws. For example, if the contract relates to interests in real property in Hong Kong, the courts will probably apply Hong Kong law to determine the issues.

SECURITY AND RISK

Creating security

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

Security over an SPV's assets is usually taken by way of either a:

- Charge (that is, an encumbrance on the assets, rather than a transfer of ownership).

- Mortgage (that is, a transfer of the legal title by way of security).

A charge both:

- Is enforceable against the SPV and third parties.
- Gives the chargee preferential access to the assets on the insolvency of the SPV.

The degree of preference depends on whether the charge is a fixed charge or floating charge:

- **Fixed charge.** Assets (which must be ascertained, or ascertainable, and definite) are appropriated to satisfy a debt between the chargor and the chargee immediately, or immediately on the assets coming into existence.
- **Floating charge.** This attaches to a class of assets (for example, future receivables) until an event occurs which causes the charge to crystallise (that is, attach to the assets in the class, effectively becoming a fixed charge).

A fixed charge has a higher priority on insolvency than a floating charge.

A charge and equitable mortgage are vulnerable if either:

- The legal interest in the assets is sold to a purchaser who:
 - is bona fide;
 - acquires for value;
 - is without notice of the security.
- The equitable interest in the assets (of which the obligor has not received notice) is sold by way of assignment to a bona fide third party giving notice to the obligor.

If the security granted is a registrable security listed in section 80(2), Companies Ordinance (Cap. 32), the chargor must register the security within five weeks after its creation (*section 80, Companies Ordinance (Cap. 32)*). This registration should constitute good notice to interested third parties. If the chargor fails to register within five weeks, the charge:

- Can lose its priority.
- Will be void against the liquidator and any creditor of the company.

The registration requirement applies to both (*section 91, Companies Ordinance (Cap. 32)*):

- Any registrable security granted by a company registered in Hong Kong.
- Any registrable security over property in Hong Kong which is acquired by a foreign company with a place of business in Hong Kong.

A mortgage over real property (or a security interest in mortgage loans creating an interest in real property) should be registered with the Land Registry as an instrument affecting interest in land (*section 2, Land Registration Ordinance (Cap. 128)*). If it is not registered, it is void against any subsequent bona fide purchaser or mortgagee for valuable consideration (but not between the parties to the security).

A charge over book entry interests in securities held in a clearing system may be security against the chargor's rights in the clearing

system (rather than in the securities themselves). This can be perfected by arrangement with the clearing system, either directly or indirectly through an intermediary custodian.

A security interest in negotiable instruments (including bearer debt securities and promissory notes), held outside the clearing systems, can 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 the pledgor's default. 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 can be created.

For further information on taking security over assets in Hong Kong, see *PLC Cross-border Finance Handbook 2010, Country Q&A, Hong Kong*.

20. How is the security granted by the SPV held for the investors? If the trust concept is recognised, are there any particular requirements for setting up the trust (for example, the security trustee providing some form of consideration)? Are foreign trusts recognised in your jurisdiction?

Security granted by the SPV is typically granted to the trustee, who holds the security on behalf of the secured creditors (which usually includes the investors).

The common law trust concept is recognised. Security granted by the SPV is usually held by the trustee on behalf of the investors and other secured creditors. Based on English law principles (*see Question 2*), a trust is generally recognised if it satisfies three certainties:

- **Certainty of intention.** There must be a manifest intention to create a trust (*Tito v Waddell (No. 2) [1977] Ch 106*).
- **Certainty of objects.** The trust must be for ascertainable beneficiaries (*Re Vandervell's Trusts (No. 2) [1974] Ch 269*).
- **Certainty of subject matter.** The property forming the subject matter of the trust must be specified with reasonable certainty (*Knight v Knight (1840) 3 Beav 148*).

For a trust to be properly constituted, the trust property must also be properly vested in the trustee.

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

Credit enhancement

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

The credit enhancement techniques set out in the Model Guide are typical (*see Model Guide, Credit enhancement*).

Risk management and liquidity support

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

The methods of liquidity support described in the Model Guide are typical (see *Model Guide, Risk management and liquidity support*).

Other variations include the:

- Issuance of extendable notes.
- Use of asset repurchase agreements.

CASH FLOW IN THE STRUCTURE

Distribution of funds

23. Please explain any variations to the Cash flow index accompanying Diagram 9 of the Model Guide that apply in your jurisdiction.

The Cash flow index described in Diagram 9 of the Model Guide is typical (see *Model Guide, Diagram 9 and box, Cash flow index*).

Profit extraction

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

The profit extraction techniques described in the Model Guide are typical (see *Model Guide, Profit extraction*).

THE ROLE OF THE RATING AGENCIES

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

Hong Kong's current sovereign ratings are:

- Standard & Poor's:
 - AA+ (long-term, stable);
 - AAA (long-term)/ A-1+ (short-term) (country ceiling).
- Moody's:
 - Aa2 (long-term, positive);
 - Aa1 (long-term)/ P-1 (short-term) (country ceiling).
- Fitch:
 - AA (foreign) and AA+ (local) (long-term, stable);
 - AAA (long term)/ F1+ (short term) (country ceiling).

Hong Kong maintains a rating that is separate from, and higher than, China's rating. This is due to both:

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

Hong Kong's strong external financial position, fiscal prudence and sound banking system are cited favourably by rating agencies.

TAX ISSUES

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

- What transfer taxes may apply to the transfer of the receivables? Please give the applicable tax rates and explain how transfer taxes are usually dealt with.
- Is withholding tax payable in certain circumstances? Please give the applicable tax rates and explain how withholding taxes are usually dealt with.
- Are there any other tax issues that apply to securitisations in your jurisdiction?

There are generally no taxes on the sale of receivables.

There is no withholding tax on interest payments by obligors to the originator or purchaser in relation to receivables.

Stamp duty is generally not chargeable on the sale of receivables. There is stamp duty on transfers of interests in land (*Stamp Duty Ordinance (Cap. 117)*). The rates are sliding, ranging from HK\$100 (about US\$13) (for prices paid for the property up to HK\$2 million (about US\$258,000)) to 3.75% (for prices paid for the property exceeding HK\$6 million (about US\$774,100)). Stamp duty is also chargeable on the transfer of stock and issue of bearer instruments.

There is no value added tax (VAT), sales tax or other similar taxes on:

- Sales of goods or services.
- Sales of receivables.
- Fees for collection agent services.

In 2006, the government proposed the introduction of sales tax but this was abandoned due to widespread public opposition.

A person carrying on a trade, profession or business in Hong Kong must pay profits tax on the profits from that trade, profession or business (*Inland Revenue Ordinance (Cap. 112)*). In general, a foreign SPV should not be deemed to be carrying on a trade, profession or business in Hong Kong if it conducts no business in Hong Kong other than:

- The purchase of receivables.
- Its appointment of the originator as its servicer and collection agent.
- Its enforcement of the receivables against the obligors.

SYNTHETIC SECURITISATIONS

27. Are synthetic securitisations possible in your jurisdiction? If so, please briefly explain any particularly common structures used. Are there any particular reasons for doing a synthetic securitisation in your jurisdiction?

Synthetic securitisations are possible. Hong Kong's legal system is based on English law (see *Question 2*), and Hong Kong has the necessary legal framework to accommodate any synthetic securitisations that have been done in other common law jurisdictions.

OTHER SECURITISATION STRUCTURES

28. Which of the various structures, set out in the Model Guide or otherwise, are commonly used in your jurisdiction?

All the structures described in the Model Guide can be used in Hong Kong (see *Model Guide, Other securitisation structures*).

REFORM

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

Following the global insolvency of Lehman Brothers, on 25 September 2009 the Securities and Futures Commission (SFC) began a public consultation on the regulation of retail structured products (this consultation process ended on 31 December 2009). If implemented, the SFC proposals would affect all parties involved in issuing and offering unlisted structured products to the public in Hong Kong. Among other things, the proposals include:

- Greater levels of disclosure.
- A narrower class of persons qualifying as professional investors.
- Restrictions on the ability to sell particular types of structured products to the public.
- Greater SFC regulatory supervision of structured product sales.

CONTRIBUTOR DETAILS

Jeffrey H Chen
Mayer Brown LLP (Hong Kong)

T +852 2843 2209
F +852 2103 5143
E jchen@mayerbrown.com
W www.mayerbrownjism.com

Areas of practice/expertise. Jeffrey H Chen is a partner at Mayer Brown LLP (Hong Kong) and heads the firm's Asian Structured Finance practice. He focuses on cross-border financing structures of all types and on engineering various types of hybrid instruments. Jeffrey advises banks, monolines, swap providers, rating agencies and corporations on major securitisations in Asia, and on various derivatives transactions, particularly credit derivatives (including their use in credit linked notes and synthetic CDOs). He is also familiar with local law peculiarities across Asian jurisdictions and co-ordinates regional local law compliance issues, such as netting and collateral. As an American lawyer, Jeffrey has experience with the issues that typically arise under US securities laws and regulations, including Regulation S, Rule 144A, and the 1940 Act. He also advises clients on compliance with Regulation AB and other rules applicable to asset-backed securities in the US. Jeffrey is an attorney in New York and the District of Columbia, and a solicitor in Hong Kong. Jeffrey is fluent in Mandarin Chinese.

Kingsley Ong
JSM (Hong Kong)

T +852 2843 2223
F +852 2103 5186
E kong@mayerbrown.com
W www.mayerbrownjism.com

Areas of practice/expertise. Kingsley Ong is a structured finance and derivatives lawyer at JSM (Hong Kong) and Mayer Brown International LLP (London), and Secretary-General of the Asia-Pacific Securitisation Association (APSA). He specialises in all types of structured financings and derivative products, including the securitisation of auto-loans, credit cards, real estate assets, trade receivables, whole businesses, CDOs and synthetic securitisations, master trust structures, asset-backed commercial paper conduits, structured investment vehicles, derivatives, repos and securities lending. In addition, Kingsley has advised extensively on defaulted securitisations, insolvency workouts, unwinding complex securitisation structures, and close-out of derivative, repo and securities lending contracts. He has acted on behalf of arrangers, collateral managers, enhancement providers, investors, issuers, liquidators, liquidity providers, originators, rating agencies, servicers, sponsors, swap counterparties, trustees, and underwriters. Kingsley is a solicitor of Hong Kong, a barrister and solicitor of England & Wales, and an advocate and solicitor of Singapore. He is fluent in Mandarin and Cantonese Chinese.