

Lending and Taking Security in Hong Kong: Overview

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A Q&A guide to lending and taking security in Argentina.

This Q&A provides a high-level overview of forms of security over assets, release of security over assets, special purpose vehicles in secured lending, quasi-security, guarantees, risk areas for lenders, structuring the priority of debts, debt trading and transfer mechanisms, agent and trust concepts, enforcement of security interests, borrower insolvency and cross-border issues on loans

Forms of Security over Assets

Real Estate

1. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real Estate

Real estate in Hong Kong is generally referred to as land and buildings, including fixtures and fittings. The primary laws that govern real estate and real estate transactions are the *Conveyancing and Property Ordinance (Cap. 219)* (CPO) and the *Land Registration Ordinance (Cap. 128)* (LRO).

Common Forms of Security

Security over land is generally taken by way of a mortgage. After 1984, a mortgage of a legal estate can only be effected at law by creating a charge by deed expressed to be a legal charge. A mortgage effected by a legal charge does not typically transfer legal title. Instead, it creates an encumbrance on the property, giving the lender the right to sell it if the borrower defaults, while the borrower retains ownership.

Formalities

Any transfer of an interest in land including the establishment of a security interest must be effected by deed to confer legal title (section 44, CPO).

There are two registration requirements:

- Registration with the [Hong Kong Companies Registry](#). The requirements for registering security interests over land and buildings apply to both companies incorporated in Hong Kong and those incorporated elsewhere but registered as non-Hong Kong companies under Part 16 of the [Companies Ordinance \(Cap 622\)](#) (CO).

Such companies are required to submit a statement of particulars, along with a certified copy of the security instrument, to the Hong Kong Companies Registry within one month of the creation of the security.

Failure to comply, subject to the court granting leave for late registration, renders the security void against a liquidator and any creditor of the company.

- Registration with the [Hong Kong Land Registry](#). It is not mandatory for security interests over land to be registered with the [Hong Kong Land Registry](#), but failure to register in time (within one month of their creation) will adversely affect the priority of the security interest.

If an instrument is registered within one month of its date of execution, it is entitled to priority from the date of execution. If an instrument is registered after one month of its execution, it is only entitled to priority from the date of registration.

Tangible Movable Property

2. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible Movable Property

Tangible movable property generally refers to physical assets that are not affixed to land.

"Movable property" is defined in the [Interpretation and General Clauses Ordinance \(Cap. 1\)](#) (IGCO) as property of every description except immovable property.

"Immovable property" is defined in the IGCO as:

- Land, whether covered by water or not
- Any estate, right, interest or easement in or over any land

- Things attached to land or permanently fastened to anything attached to land

Examples of tangible movable property include:

- Machinery
- Inventory such as goods, furniture or appliances
- Aircrafts, ships and other large plant machinery (for example, excavators)
- Various forms of personal chattels that can be transferred by delivery

Common Forms of Security

Charge. Security over tangible movable property is commonly established by way of a charge. Legal title remains with the chargor, who grants a security interest in favour of the chargee.

A floating charge is a security interest over a class of present and future assets of a company that may change from time to time, and until "crystallization", the company may deal with the assets in that class in the ordinary course of business. It is typically the preferred form of security for trading businesses or operating companies.

Floating charge instruments usually include a crystallisation provision, enabling the chargee to restrict the 'chargor's ability to use the assets on the occurrence of certain specified events, for example, on the insolvency of the debtor.

It is not unusual for a charge over tangible movable property (and intangibles) to be described as a fixed charge; however, this designation is not conclusive. If the courts determine that the chargee has not exercised sufficient control over the charged property, the charge can be recharacterised as a floating charge. A fixed charge generally outranks preferential creditors, while a floating charge is subject to preferential debts.

Pledge. A pledge represents the most traditional method of securing tangible movable property, involving the pledgee taking possession of the physical asset or its documents of title. However, the use of pledges has declined in commercial practice, as the loss of possession is often impractical for operating companies.

Formalities

Charge. If given by a Hong Kong company (or a registered non-Hong Kong company over Hong Kong property) and it falls within a "specified charge" under the CO section 334(1), it must be filed at the Hong Kong Companies Registry by delivering Form NM1 with a certified copy of the charge instrument within one month of creation. Failure to file in time (without a court extension under section 346) is an offence and renders the security void against the liquidator and any creditor.

Pledge. No Companies Registry filing is generally required for a pure pledge but it could be recharacterised depending on its terms and then be subject to the registration requirement.

3. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial Instruments

The most common financial instruments over which security is granted are shares and debt securities. Inter-company loans and other receivables are addressed in [Question 4](#).

Common Forms of Security

Shares. For unlisted shares of a Hong Kong private or public company, the usual method is to take a mortgage or charge over the shares.

For shares of a Hong Kong company listed on the [Hong Kong Stock Exchange](#) (HKEX), the shares can be held in a certified or uncertified form. The method for taking security over listed shares in certified form is the same as for unlisted shares.

Uncertified shares are generally held in the Central Clearing and Settlement System (CCASS), which is a central counterparty settlement and depository system for trades in stocks listed at the HKEX. The legal title to all the shares held in CCASS are registered in the name of a common nominee for CCASS. All "owners" of uncertificated/dematerialised shares only have beneficial interests in the shares held by them. Security over shares held in CCASS therefore takes the form of a charge.

Debt securities. For debt securities, some are held in the Central Moneymarkets Unit Service (CMU) operated by the [Hong Kong Monetary Authority](#) (HKMA), and the debt securities are lodged with a sub-custodian appointed by the HKMA. Others can be held in CCASS or by the Hong Kong Securities Clearing Company Limited (HKSCC).

Security is usually taken over debt securities in the CMU or CCASS by way of a charge.

Formalities

Shares. The security over certificated shares commonly takes the form of an equitable mortgage or a charge and is perfected by taking possession of the original share certificates and obtaining pre-executed, undated instruments of transfer and contract notes from the mortgagor/chargor. The mortgagor/chargor remains the registered holder of the shares.

Alternatively, if the share security is created by way of a legal mortgage, the legal title of the shares is transferred to the mortgagee whose name is then recorded in the 'register of members', with an agreement for re-transfer on repayment of the secured debt.

For shares listed on the HKEX in certified form, the formalities for taking security over them are the same as for unlisted shares. An "owner" of uncertificated/dematerialised shares held in CCASS usually holds those shares through a securities account with a broker (or holds a direct account with CCASS, but this is rare). There may be disclosure obligations where the shares provided as security exceed a certain percentage of a listed company share capital.

Security over shares held in CCASS usually takes one of two forms:

- By creating a charge over the shares in the securities account, as well as the 'chargor's rights in respect of such securities account. The broker is notified of the security interest and must usually acknowledge the notice, which often includes undertakings to follow instructions from the chargee.
- By transferring the shares from the 'chargor's securities account with its broker to the securities account of the chargee or its nominee. This method is similar to an equitable mortgage over the beneficial interest in the shares (there is no change to the registered holder at the issuer's level).

Debt securities. If the debt securities are held in CMU, it is advisable to transfer them to the account of the chargee with its own nominated CMU member. If the debt securities remain in the account of the security provider with its nominated CMU member, notice of the security should be given to the security provider's nominated CMU member, and, preferably, an acknowledgement obtained.

4. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and Receivables

The most common types of claims and receivables over which security is granted include:

- Rights to receive a debt (including book debts and inter-company debts).
- Trade receivables.
- Rights to payment under a specific contract.
- Rights to insurance proceeds.

Common Forms of Security

The most common forms of security granted over claims and receivables is in the form of an assignment by way of security or a fixed charge.

Formalities

Under section 9 of the [Law Amendment and \(Consolidation\) Ordinance \(Cap. 23\)](#), a legal assignment of a debt or legal chose in action must be in writing, absolute and unconditional, signed by the assignor and have express written notice given to the debtor.

Following the assignment, the assignee obtains the legal right to a debt, including the power to sue for it directly, and can take action against the debtor (of the assigned debt or receivable) in its own name without needing to join the assignor as a party to the action.

An assignment by way of security is the assignment of such rights to the lender solely to secure an obligation; subject to reversion once the debt is repaid.

Equitable assignment arises when the assignment does not satisfy the statutory requirements for a legal assignment. Such an assignment:

- Can be created without a deed, and is effective between assignor and assignee without notice to the debtor.
- Can cover present or future receivables and can assign part of a debt.
- Can be preferable where it is commercially impractical to give notice to the relevant debtor(s).

However, it could rank behind competing claims to the same receivables as the order in which notices of assignment were given to the obligor determine priority according to the rule in *Dearle v Hall* ([Dearle v Hall \[1828\] 3 Russ 1](#)) (unless the assignee of the later assignment had knowledge at the time of the assignment of the existence of the earlier assignment).

Where it is not practical to serve notice or specifically identify all contracts, a charge is usually taken. A charge over receivables can be particularly useful where the debt document prohibits assignment by the creditor or receivable holder, provided the contract does not also prohibit charging or creating security.

If a fixed charge is taken, the lender must be able to have sufficient control of the charged receivables and their proceeds. If a security provider can collect and deal with the security assets without the lender's consent or control, the fixed charge can potentially be recharacterised by the court as a floating charge.

A charge over book debts is a specified charge under the CO and is required to be registered with the Hong Kong Companies Registry if granted by a Hong Kong company or a foreign company registered as a non-Hong Kong company.

If a company maintains a deposit of money with another person (whether the money is deposited by the company or by any other person for the company's benefit), a charge on the company's right to repayment of the money is not regarded as a charge on book debts of the company. As such, a charge over a bank account is not registrable as a specified charge.

There remains a risk that, depending on the degree of control exercised over the account and whether the company is free in practice to use the funds in the ordinary course of business, any purported fixed charge could be recharacterised by the court as a floating charge (which is registrable) (see *Question 2, Common Forms of Security*). If so, it will be subordinated to preferential creditors and will need to be registered to avoid being void against the liquidator and other creditors.

In practice, secured parties tend to register their charge over any property, even if it does not constitute a specified charge, out of an abundance of caution and to put subsequent security takers on notice.

Cash Deposits

5. What are the most common forms of security over cash deposits? How are they created and perfected?

Common Forms of Security

The type of security interest taken over cash deposits in Hong Kong varies based on whether the financial arrangement is between two parties or involves more than two parties:

- **Charge.** Where the cash collateral is held in an account under the borrower's name with the lender also acting as the account bank, the security is typically established through an account charge granted by the borrower in favour of the lender.
- **Assignment.** When the lender and account bank are separate entities, and there are more than two parties involved, the security provider can assign its rights and benefits in the account (held with the account bank) to the lender.

Formalities

Charge. A charge over a bank account is not required to be registered with the Companies Registry (see [Question 4](#)). This exclusion is based on the assumption that the account bank can always use its right of set-off against the account holder/borrower. However, where the account charge agreement creating the security also contains a floating charge, it must be registered, as all floating charges on the company's undertaking or property are "specified charges" under section 334(1)(j) of the CO, regardless of the type or location of the assets they cover.

Assignment. The security provider assigns to the lender its contractual rights to the account, which is a chose in action, with the account bank as the "debtor" in respect of that chose in action.

The assignment should:

- Be in writing and signed by the assignor.
- Clearly identify the account, the rights assigned and that the assignment is by way of security.

Written notice of the assignment should be given to the account bank, and the bank's written acknowledgement should be obtained where possible.

See [Question 4](#) for the distinction between legal and equitable assignments.

Intellectual Property

6. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual Property

Intellectual property rights (IPR) encompass a broad spectrum of rights, including trade marks, copyrights, patents, designs and database rights. These rights can be registered or unregistered and include any licences associated with them.

Common Forms of Security

Security over IP is typically taken by way of a charge.

Formalities

Security over IPR may qualify as a "specified charge" if it is a:

- Charge on goodwill.
- Patent or a licence under a patent.
- Trade mark.
- Copyright or a licence under a copyright.

(Section 334(1), CO.)

If the charge is a specified charge, it must be registered with the Companies Registry within one month of creation.

In addition, the security should be registered at the relevant registry, for example:

- Security over patents and registered designs must be recorded at the [Patents Registry](#).
- Security over a registered trade mark must be registered at the [Trade Marks Registry](#).

Problem Assets

7. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

The following assets and types of charges present certain difficulties:

- **Future assets.** It is not possible to create a legal mortgage over assets that exist only in the future, since there is no proprietary right to something that is not yet owned. However, security over such assets can still be achieved by an equitable charge.
- **Fungible assets.** Securing fungible assets (for example, cash or inventory) in Hong Kong is possible, although it is crucial to define the exact subset of fungible assets to which the security applies. Lenders often require these assets to be set aside or otherwise earmarked to be sure that their security interest is valid and attaches to specific property.
- **Other types of assets.** In some cases, establishing security over assets such as a leasehold or contract right requires consent, or a release, from a third party before the charge can be created. Proceeding without consent may render the security ineffective against the third party and expose the chargor to breach or forfeiture. Separately, failing to ensure that the security is properly registered or "perfected" can risk losing priority to other creditors, especially if a subsequent buyer acquires the rights without knowledge of the existing security.
- **Fixed charge and floating charge.** When a lender wishes to take a fixed charge over all the borrower's assets, a key issue is that a fixed charge usually requires the lender (not the owner) to have control. The asset cannot be freely used or sold by the owner in its ordinary business. See *Question 4, Common Forms of Security*

If, in practice, the owner uses or disposes of the asset as part of its usual business operations, there is a risk that the fixed charge could be recharacterised by the court as a floating charge, which would then rank behind preferential creditors. Additionally, where the borrower is allowed to use the proceeds as they wish, the court can still treat that as a floating charge even if the lender claims to have full control (and therefore a fixed charge) over certain receivables.

The distinction hinges on how much actual control the lender exercises. Whether there is enough control by the secured party will depend on the particular circumstances.

Release of Security over Assets

8. How are common forms of security released? Are any formalities required?

The release of secured interests is usually formalised by executing a deed of release.

When security interests are registered with the Companies Registry, the following must be provided for deregistration:

- A certified true copy of the documentation that confirms repayment or discharge, or evidence that the security has been released or has ended (for example, a deed of release).
- Form NM2.

In addition, certain registries, such as those for property, trade marks or civil aircraft in Hong Kong, may have their own requirements for deregistration.

Special Purpose Vehicles (SPVs) in Secured Lending

9. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

It is common for lenders to secure their interests by taking collateral over the shares of an SPV, often accompanied by an all-asset debenture granted by the SPV.

Quasi-Security

10. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

A quasi-security arrangement can take the following forms:

- **Sale and leaseback.** An owner sells an asset to another person or entity but then leases it back, typically for a set period. If the lessee defaults, for example, by missing rent or breaking lease terms, the lessor can reclaim the asset.

- **Factoring.** Factoring deals allow a person to assign rights to outstanding invoices or receivables to a "factor". The factor usually pays a cash sum (of less than the face value of the amount owed) to the assignor, and the actual discount varies depending on the specific factoring type:
 - Non-recourse factoring: The risk of non-payment by the debtor is absorbed by the factor; or
 - Recourse factoring: If the debtor fails to pay, the assignor must cover the shortfall.

Some loan agreements prohibit factoring or require consent before any assignment can be effected. If the contract governing the assignor's receivables contains restrictions on assignment, this can block future factoring deals.

- **Hire purchase.** Hire purchase is a typical way to finance physical property, especially vehicles. The lessor keeps ownership but allows the lessee to use the item and eventually:
 - pay off the value in instalments and take title; or
 - terminate the arrangement and hand the item back.

The asset remains in the lessor's name, and the lessee cannot transfer or use it as collateral for any other financial obligation. The lessor can reclaim the asset if lease terms are broken.

- **Retention of title.** A retention of title clause permits the seller to retain legal ownership of goods sold until full payment in respect of the purchase price is made, even if the purchaser acquires possession of the asset. If the goods are totally transformed or mixed with other goods and can no longer be recognised, it may be difficult for the seller to assert title and retake the goods, despite the retention of title clause.

Formalities

A quasi-security arrangement (see [Question 10](#)) could be treated as if it were a grant of security, in which case, grantors that are companies incorporated or registered in Hong Kong or non-Hong Kong firms registered under Part 16 of the CO must register the security with the Companies Registry.

Guarantees

11. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are widely used in Hong Kong. Guarantees can be included in the loan agreement itself. When issued independently, guarantees are commonly executed as deeds to avoid disputes over whether consideration was given.

In loan agreements, guarantee clauses typically provide the scope of covered liabilities and the nature of the guarantor's undertaking. Such clauses:

- Must state whether the guarantee relates to a third party's debts or obligations and whether those are payment or performance related.
- Should state whether the guarantor is liable as a primary obligor or as a secondary surety.
- Typically state whether the guarantee is unconditional, irrevocable and continuing and specify any caps, limitations or carve#outs.

Granting guarantees can also raise concerns about corporate benefit, as well as regulatory or financial assistance considerations. (See also [Question 13](#).)

Risk Areas for Lenders

12. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial Assistance

It is unlawful for a company or its subsidiaries to provide financial assistance for the purpose of the purchase of its own shares by another person (section 275, CO). The CO defines the term "financial assistance" as:

- Financial assistance given by way of gift.
- Financial assistance given by way of a guarantee, security, indemnity (other than an indemnity in respect of the 'indemnifier's own neglect or default) or by way of release or waiver.
- Financial assistance given by way of a loan or any other agreement under which any obligations of the person giving the assistance are due to be fulfilled at a time when any obligation of another party to the agreement remains unfulfilled or through the novation of or the assignment of rights arising under the loan or agreement.
- Any other financial assistance given by a company if:
 - the net assets of the company are reduced to a material extent by the giving of the assistance; or

- the company has no net assets.

Despite the general restriction against the provision of financial assistance by a company or its subsidiaries for the purchase of its own shares, if the directors confirm that the company is solvent and resolve that the giving of the financial assistance is in the best interest of the company, a company can provide financial assistance under prescribed exemptions, including, where the financial assistance:

- Does not exceed 5% of the paid-up share capital and reserves of the company.
- Is unanimously approved by the shareholders.
- Is approved by an ordinary resolution of the company.

The directors of the company must make a solvency statement and resolve that the giving of the assistance is in the best interest of the company.

If an ordinary resolution is passed approving the financial assistance, shareholders holding at least 5% of the voting rights and who voted against the resolution can petition the court for an order restraining the proposed assistance, subject to the requirements in the CO.

Financial assistance is also be permitted under the CO when both:

- It is given in good faith in the interests of the company.
- The principal purpose of the transaction is not the acquisition of shares in the company (or its holding company) or reducing or discharging a liability incurred for such acquisition, or the giving of the assistance falls within part of the ordinary business of the company.

Corporate Benefit

Directors must ensure that any guarantee or other support given by their company truly serves the interests of the company. A board member should only approve a transaction if there is a clear benefit to the company offering support.

For example, the benefit could be a new revenue stream or other commercial advantage, including an indirect benefit, such as supporting another group company. The extent to which an indirect advantage is acceptable depends on facts, and directors are advised to seek shareholders' approval in uncertain circumstances'.

Ultimately, if there is no clear advantage for the company itself, directors risk breaching their fiduciary duties. In some circumstances, a lack of corporate benefit can result in the transaction being subject to challenge.

Loans to Directors

Companies cannot usually give loans or similar financial benefits to their own directors (including shadow directors) or to related companies where the director holds an interest (CO section 500), subject to a few exceptions, including when:

- The aggregate of the value of the transaction in question, and the value of any other relevant transaction or arrangement, does not exceed 5% of the value of the company's net assets.
- The loan forms part of the company's usual business and is made on reasonable terms.

Usury

The *Money Lenders Ordinance (Cap 163)* (MLO) regulates the business of money lenders.

Any lender that is not an authorised institution must consider any relevant requirements under the MLO when its proposed lending has a Hong Kong connection, including whether it qualifies as an exempted lender and/or its loan qualifies as an exempted loan under the MLO.

Additionally, lenders must not charge above legally set maximums. In particular:

- Any agreement for the repayment of a loan or for the payment of interest with an effective interest rate exceeding 48% is illegal and unenforceable.
- An effective annual interest rate between 36% and 48% is presumed to be extortionate unless the court is satisfied that such rate is reasonable and fair with regard to all relevant circumstances.

Avoidance Action in Insolvency

See [Question 20](#).

13. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

Environmental regulations in Hong Kong are mainly aimed at managing, preventing or remediating issues connected to:

- Excessive noise
- Pollution affecting air, water or seas
- Disposal of waste materials

- Land that has become polluted

Typically, lenders do not face liability under environmental regulations unless they become actively involved in operating or managing the business or assets of a borrower, guarantor or security provider.

However, if a lender takes action to assume direct control over a secured asset (for example, when they take possession and manage day-to-day operations of the relevant collateral on enforcement), they can become directly responsible and potentially liable under environmental law.

Structuring the Priority of Debts

14. What methods of subordination are there?

Agreed Subordination (Contractual)

In Hong Kong, junior lenders (creditors that provide subordinated financing to a borrower) and senior lenders can agree contractually (for example, in a subordination or intercreditor agreement) that junior lenders cannot claim and/or receive payment on certain debts until the senior lenders have been paid in full.

This can also be achieved through a contingent debt provision or looser terms on junior debts without a separate subordination agreement, deferring the junior lenders' right to payment, giving senior lenders more leverage in negotiations or restructuring.

Group/Subsidiary Structure (Structural Subordination)

In an acquisition financing, loans are often made to a parent company that owns a separate entity holding valuable assets, with no guarantee or security given by the subsidiary. In such an arrangement, the lender to the holding (parent) company can only claim against that parent company (and, if the lending is secured by a security given by the parent company, that parent company's assets (shares in its subsidiary company)), rather than against the subsidiary or its assets directly.

If a subsidiary with substantial assets is involved, those assets must first cover the subsidiary's own debts before paying the parent 'company's creditors.

In practical terms, lenders to the subsidiary therefore rank ahead of those lending to the holding company.

Intercreditor Agreements

When a borrower has secured multiple layers of financing, clear arrangements are needed between senior and junior lenders. Intercreditor agreements set out the rules governing their respective claims and often require junior financiers to agree to the following:

- Debts are paid in a specific order, and prepayments or changes to terms require prior approval by the senior lenders (or a majority of them), especially before any default or acceleration occurs.
- The commercial actions of the various creditors are tightly controlled, including requirements for:
 - standstills;
 - how security is enforced;
 - how votes are taken on amendments or waivers; and
 - how events of default are dealt with.
- If junior creditors receive any payment before the senior creditors are paid in full, especially in insolvency situations, they are typically required to turn over such amounts to the senior creditors.

Debt Trading and Transfer Mechanisms

15. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Under Hong Kong law, the sale and purchase of debt and/or a loan can be effected through the assignment or novation of the relevant debt document, provided that any transfer conditions prescribed by the original debt document are satisfied. For a syndicated loan, the security is typically held by a security agent, which means that assignment or novation of loans will not affect security or require re-registration.

Where there are restrictions against assignment or novation in the underlying debt documents, the purchaser of the debt can seek to obtain indirect exposure to the debt through sub-participation agreements or other derivative arrangements (such as total return or credit default swaps).

Debt transfer mechanisms include:

- **Assignment.** The current lender (assignor) signs over their rights in the credit documents to a new lender (assignee). However, a lender is not permitted to assign its obligations, including any undrawn commitments. There is usually a form of the assignment agreement in the loan agreement for parties to use as a base.

- **Novation.** If all parties including the borrower agree, a lender can completely offload both its rights and obligations to another lender through novation. This is especially common for loans involving multiple lenders. There is usually a form of the transfer certificate in the loan agreement which effects a novation.

The participants (borrower, outgoing and incoming lenders and the agent bank) typically execute formal transfer documents. When done properly, the existing lender's rights and duties are assumed by the new party, without any impact on the rest of the structure.

- **Sub-participation.** This occurs where the economic benefit of the loan is transferred to the participant, but this does not affect the original loan contract between the original lender and the borrower. In a sub-participation arrangement:
 - there is no official transfer of the lender's position;
 - the seller and borrower's direct legal relationship under the loan contract is not affected;
 - the arrangement is entirely between the seller and the participant, often privately, and the borrower may not even know about it; and
 - any security backing the loan also remains with the seller or the security agent (as applicable), although the economic benefit derived from it is typically transferred to the participant.

Agent and Trust Concepts

16. Is the trust or agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

Agent Concept

The agent concept is recognised under Hong Kong law. The appointment and authority of the agent are subject to common law principles of agency and the relevant contractual provisions in the loan agreement itself or in a separate agency agreement, and its role is often solely mechanical and administrative in nature.

Trust Concept

The trust concept is recognised under Hong Kong law. In the context of a syndicated loan transaction, it is not uncommon to have security granted by the security provider in favour of a security trustee appointed under the financing documents who holds the security on trust for the benefit of itself (as the security trustee), any receivers it appoints, the lenders and other financing parties.

Enforcement of Security Interests

17. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? How are the main types of security interest usually enforced? What requirements must the lender comply with?

The ways in which a lender can take action to recover a loan, enforce a guarantee or realise security typically depend on what is agreed in the relevant finance or security documents.

These agreements usually set out specific events of default the occurrence of which will entitle the lenders or the security agent to accelerate repayment or call on the security or guarantees. Such triggers typically include (for example):

- Non-payments.
- The borrower becoming insolvent or starting insolvency proceedings.
- Failure to meet key covenants or obligations set out in the agreement, and following the expiry of any applicable grace period.

The usual process for enforcing security against most assets (including, for example, listed and unlisted shares and land) is to appoint receivers, who can then sell the assets through a receivership sale. The process is as follows:

- The appointment of a receiver is typically effected by way of a deed of appointment. Certain receivers may also require their appointors to sign a deed of indemnity in their favour. A notice of appointment must be filed with the Companies Registry.
- The appointment of receivers, in enforcement of a contractual security, does not require approval from the Hong Kong court, provided that the security documents contain the appropriate receivership provisions.
- The receivers generally have broad powers under the security document and the CPO to take control of and manage the assets to which they are appointed.
- The receivers have a degree of latitude in the method of sale used to dispose of the asset, subject to the receiver's general duty of care to obtain the best price reasonably obtainable in the circumstances. That duty typically requires the receiver to properly test the market in a manner that is appropriate to the nature of the assets being sold. Public auctions are not mandatory and private sales are possible, depending on the nature of the assets.

- Once appointed, the receiver acts as agent of the security provider and must exercise its powers in good faith for the purpose of preserving and realising the assets comprised in the security and obtaining repayment of the secured debt. There is a prohibition against self-dealing by the receiver.

Borrower Insolvency

Rescue, Reorganisation, and Insolvency

18. Are company rescue or reorganisation procedures (other than insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

There is no formal company rescue procedure under Hong Kong law. Hong Kong companies seeking to restructure their debts and avoid liquidation typically pursue informal workouts or schemes of arrangement. Where the debtor company is incorporated offshore or has English law-governed debts, it may also pursue restructuring processes in the relevant offshore jurisdiction or in the UK.

Informal Workout

Informal workouts comprise contractual arrangements between a debtor company and its creditors. It is up to the parties to agree on an acceptable arrangement for compromising the debts in question. It may be possible for the parties to negotiate an informal standstill (on enforcement), but that is relatively rare.

Scheme of Arrangement

Under Hong Kong law, a scheme of arrangement involves a three-stage process:

- Stage 1: an initial hearing is held by the Hong Kong Court ("convening hearing"), at which the court is asked to make an order convening the relevant scheme meeting(s) (where the scheme creditors or classes of scheme creditors will vote on the proposed scheme). Any issues with respect to the determination of the scheme classes are typically determined at this first hearing.
- Stage 2: the scheme meeting(s) will be convened in accordance with the convening order made by the Hong Kong court. At each such meeting, a majority (over 50%) in number, representing at least 75% in value, of creditors present and voting must vote in favour of the proposed scheme for it to be approved.
- Stage 3: after the scheme creditors have approved the proposal at the scheme meeting(s), the debtor then returns to court for a subsequent hearing ("sanction hearing"), at which it asks the court to sanction the proposed scheme.

'At the sanction hearing, the court typically considers, among other things, whether:

- the scheme meeting(s) were properly convened;
- there were sufficient disclosures in the explanatory statement circulated to the scheme creditors;
- each scheme class has been fairly represented and has voted bona fide in the genuine interests of the class; and
- the proposed scheme is fair and reasonable in the circumstances and there are no irregularities at the scheme meetings.

19. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

A winding up order or the appointment of provisional liquidators triggers an automatic stay on legal actions or proceedings against the company, subject to the leave of the court.

The rights of a secured creditor to enforce its security are, however, generally not affected by the commencement of insolvency procedures subject to the avoidance regime (*see Question 20*).

After a winding up petition has been filed against a company, any post-petition disposal of assets by the company will, if the company subsequently enters into liquidation, be void under section 182 of the *Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32)* (CWUMPO), unless the court orders otherwise.

Therefore, where a lender does not have security, any post-petition repayment made by the debtor to that unsecured lender could be void as above.

20. What transactions involving loans, guarantees or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

When a company enters liquidation, certain transactions can be challenged under the CWUMPO and the CPO:

- **Transactions at an undervalue.** Transactions at an undervalue by companies that enter insolvency within five years of the commencement of winding-up can be challenged in court by a liquidator and can be set aside if found to be improper. A transaction with a person at an undervalue occurs where:

- a company makes a gift to that person, or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration; or
- the company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.
- (Section 265D, CWUMPO.)

For the court to set aside the transaction under section 265D, the company must be insolvent at the time of or rendered insolvent in consequence of the transaction, with insolvency presumed if the transaction is with a connected person.

The court will not set aside the transaction if it is satisfied that the company entered into it in good faith and for the purpose of carrying on its business, and at the time, there were reasonable grounds for believing that it would benefit the company.

- **Unfair preference.** This is defined as doing anything or allowing anything to be done to put a person (typically an unsecured creditor) in a better position than that in which they would have been in an insolvent liquidation, driven by the debtor's desire to prefer that creditor during insolvency (section 266A, CWUMPO).

The look-back period is six months before winding up, and in the case of an associate, up to two years.

An "associate" is someone closely connected to another person, such as a spouse, partner, relative or someone in a business partnership or trust relationship with them (section 265B, CWUMPO).

For the court to set aside the transaction under Section 266, the company must be insolvent at the time of or rendered insolvent in consequence of the transaction, with insolvency presumed if the transaction is with a connected person.

- **Floating charges:** Floating charges can be held to be partially or wholly invalid if the company creates the charge at the relevant time, that is:
 - up to 12 months before commencement of the winding up for non-connected persons; and
 - up to two years for connected persons.(section 267, CWUMPO.)

The above does not apply to 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;
- property or services supplied to the chargor at the same time as, or after, the creation of the floating charge; or
- interest payable under the terms of the charge or the underlying transaction document rate specified in the charge or transaction document or 12% per annum (whichever is the least).

For a floating charge to be invalidated, it must have been created at a time when the company was insolvent, or the company must have become insolvent as a result of creating the charge, with insolvency presumed if the transaction is with a connected person.

- **Extortionate credit transactions:** A credit transaction is extortionate if it involves excessively high payments or significantly violates fair dealing principles (section 264B, CWUMPO).

The liquidator can apply to set aside such transactions if they were entered into within three years before the winding up.

The transaction is presumed extortionate if the effective interest is between 36% and 48% per annum. The lender can try to rebut that presumption, but the court may vary terms (including reducing interest) or otherwise "do justice between the parties".

If the effective rate exceeds 48% per annum, the loan is unlawful and cannot be enforced.

- **Transactions defrauding creditors:** Any property disposition made with the intent to defraud creditors is voidable by any prejudiced person (section 60, CPO). There is no time limit, and the application of the provisions does not depend on insolvency or winding up.

21. In what order are creditors paid on the borrower's insolvency?

The order of payments in a liquidation is as follows:

- Secured creditors (including fixed charge holders and creditors with a proprietary interest in assets). These assets fall outside of the liquidation estate.
- Costs and expenses of the winding up.
- Preferential debts prescribed by section 265 of the CWUMPO (for example, wages and salaries owed to employees during the four months before the commencement of the winding-up, subject to monetary limits).
- Floating charge holders.
- Unsecured creditors.
- Shareholders.

Except for fixed charge holders and creditors with a proprietary interest in assets, each class of creditor generally shares distributions *pari passu* with each other creditor within that class (subject to specific rules under CWUMPO for certain preferential debts).

Priority among secured creditors over a specific asset is generally determined by reference to the date of creation of the security or by agreement between such creditors. If security is created on the same date:

- Legal interests prevail over equitable interests unless there was notice of prior equitable interests.
- Between competing equitable interests, the first in time prevails (for example, a first floating charge ranks above a second floating charge).
- A fixed charge typically takes priority over a floating charge (even an earlier one). The exception to this is where a fixed charge loses priority to an earlier floating charge because it was created:
 - with actual notice of a negative pledge clause in the earlier floating charge, prohibiting the creation of the fixed charge; or
 - after crystallisation of the floating charge.
- Between successive assignees of debts, the first assignee to give notice to the debtor (and without notice of an earlier assignment) has priority over other assignees.

Cross-Border Issues on Loans

22. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders, or taking guarantees from foreign subsidiaries of the borrower?

Generally, there are no restrictions on:

- Granting security or guarantees in favour of foreign lenders.
- Taking guarantees from foreign subsidiaries of the borrower (subject to any potential corporate benefit and financial assistance issues).

However, any lender that is not an authorised institution must generally consider any potential implications under the MLO when its proposed lending has a Hong Kong connection, including whether it qualifies as an exempted lender and/or its loan qualifies as an exempted loan under the MLO.

Even if the relevant exemptions apply and the lender does not have to be licensed under the MLO, its loan may still be subject to certain provisions of the MLO regarding extortionate credit (*see Question 12*).

23. What regulatory requirements does a UK lender have to comply with to purchase a loan made to a borrower in your jurisdiction?

There are no specific regulatory requirements with which a UK lender must comply to purchase a loan made to a borrower in Hong Kong. The UK lender must, however, consider the MLO implications (*see Question 12*) and the provisions of the loan documentation to ensure that the transfer meets any contractual requirements.

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