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Section 1 – Bank licences

1.1 What licences or approvals do lenders need to have if lending to a borrower in this jurisdiction if a) the lender is a bank or b) the lender is not a bank?

Under the Money Lenders Ordinance (Cap. 163) (MLO), a lender must obtain a money lender's licence, unless such lender: (i) is an exempted person; or (ii) makes an exempted loan (see section 1.2).

1.2 Are any exemptions available and/or are any techniques typically used to structure around such requirements?

The MLO provides for certain categories of exempted persons and exempted loans. One example of an exempted person is a bank which is: (i) incorporated or established outside Hong Kong; (ii) recognised as a bank by the relevant foreign banking supervisory authority; and (iii) carries on banking business where such foreign banking supervisory authority is located.

A money lender's licence is also not required if the lender makes an exempted loan. Examples of exempted loans include loans made to a company: (i) which has a paid-up share capital of not less than HK\$1 million (\$129,000); or (ii) where such company provides security which is registered under Companies Ordinance (Cap. 622) (CO), if such company is incorporated in Hong Kong under the CO; if it is incorporated outside of Hong Kong, it must provide security which would be registrable under the CO if it were incorporated under the CO.

Section 2 – Security interests

2.1 Can security be taken over the following asset classes and what documentation or formalities are required to create, perfect and maintain such security?

- a) shares
- b) bank accounts
- c) receivables
- d) contractual rights
- e) insurance policies
- f) real property
- g) plant and machinery
- h) intellectual property
- i) debt securities
- j) future/after acquired property
- k) floating charges over all assets

Security can be taken over all the above asset classes. The security agreement is usually executed by the chargor as a deed. Security that is created by a Hong Kong company (or by a non-Hong Kong company that is registered in Hong Kong) must be registered with the relevant registry in Hong Kong (see section 2.8).

Where security is taken over bank accounts, receivables, contractual rights and insurance policies, security is perfected by giving notice to the relevant third party (an acknowledgement of the notice from the third party, although not necessary for perfection of security, should also be obtained).

Where security is taken over shares, it is customary for share certificates, instruments of transfer, and contract notes (each executed in blank) to be delivered to the secured party to enable an effective transfer of the shares on enforcement. It may also be necessary to amend the articles of association

of the company whose shares are being charged to remove any restrictions on the transfer of the shares if the security becomes enforceable.

Where security is taken over real property, it is common for the title deeds relating to the real property to be delivered to the secured party. Real property in Hong Kong is predominately leasehold under a government lease and due diligence should be conducted on the terms of the government lease to ensure that it does not contain any restrictions on the granting of security.

2.2 Highlight any issues with securing obligations that may arise in the future.

Future obligations can be secured by a security agreement, provided that the security agreement reflects a contractual intention of the parties for the scope of the obligations secured thereunder to cover both existing and future obligations. The future obligations should also be identifiable at the time of the parties' entry into the security agreement.

2.3 Can a universal security agreement be used to grant security over all assets in this jurisdiction?

Yes. A universal security agreement (such as an all-assets debenture) can be used. It should expressly specify the types of asset that are provided as security and may also include a floating charge over all assets and undertaking of the chargor.

2.4 Can security be granted for the benefit of different classes of creditors under the same security agreement and if so, are there any issues that creditors should be aware of in adopting this approach?

Yes. The security agreement may contain subordination provisions specifying the priority among different classes of creditors. However, such provisions are more commonly set out in a separate intercreditor or subordination agreement.

2.5 Can security trustee or security agent structures be used in this jurisdiction to secure obligations that are owed to fluctuating creditor classes?

Yes.

2.6 Briefly outline any issues to consider when transferring loans and accompanying security interests between lenders.

There are usually no issues, as the loan agreement typically sets out clearly the conditions to be fulfilled for such transfers (one of which may be a requirement to obtain the consent of the borrower). However, issues may arise if: (i) security is not held by a security trustee or agent on behalf of all lenders from time to time; (ii) the transferee lender is incorporated in a jurisdiction which does not recognise security that is held on trust; or (iii) if a new lender does not have a money lender's licence and the MLO exemptions do not apply (see section 1.2).

2.7 Can security be granted by third parties? Are there any rights of contribution, subrogation or similar that might arise as a result of granting/enforcing third party security that ought to be/can be waived?

Security can be granted by third parties. Rights of subrogation arise automatically under Hong Kong law where a third party discharges the secured obligations owed by another party. In those circumstances, the claims of that third party will be subrogated to the claims of the creditor whose debt

is discharged. Generally, a chargor's rights of subrogation are waived contractually (for example under the security agreement) until all secured obligations have been irrevocably and unconditionally discharged.

2.8 Briefly outline the registration requirements, if any, applicable to security interests created in this jurisdiction, including considerations such as the timing, expense and the consequences of non-registration.

Certain types of security interests (such as a charge on uncalled share capital of the company, a charge on book debts of the company, or a charge on calls made but not paid) created by: (i) a Hong Kong company; and (ii) a registered non-Hong Kong company, are required to be registered at the Hong Kong Companies Registry within one month of their creation. A registered non-Hong Kong company is only required to register specified charges in relation to property located in Hong Kong.

Registration requires the delivery of the following documents to the Hong Kong Companies Registry: (i) a completed and signed Form NM1 with the prescribed fee (HK\$340 at the time of writing); and (ii) a certified true copy of the instrument creating the charge.

If a company fails to register the security agreement before the one-month deadline, the company and every responsible person of the company is liable to prosecution and fines. Registration out of time is possible but will require an application to the courts. Failure to register will result in the relevant charge becoming void against any liquidator and creditor of the company. Although it is the company's obligation to register any registrable security that it creates, it is customary for lenders' counsel to make the necessary filings and ensure that the security is properly registered.

Certain assets (such as trade marks) have their own registries. Security created over those assets would also be registrable at the relevant registry.

2.9 Briefly outline any regulatory or similar consents that are required to create security (other than board/shareholder approvals).

None.

Section 3 – Guarantees

3.1 Briefly explain the downstream, upstream and cross-stream guarantees available, with reference to any particular restrictions or limitations.

Downstream, upstream and cross-stream guarantees may be provided by a Hong Kong company, provided that there are no restrictions in the company's articles of association on providing guarantees and the board of directors of the company are properly authorised to enter into the relevant guarantees on behalf of the company. Such guarantees should also be of corporate benefit to the guarantor. For upstream and cross-stream guarantees, where the corporate benefit to the guarantor may not be obvious, it is customary for such guarantees to be approved by unanimous board and shareholder resolutions of the guarantor.

The provision of guarantees by a Hong Kong company is limited by rules on financial assistance. In the context of an acquisition of a target company, the prohibition on financial assistance under the CO may apply if the target company or any of its subsidiaries provides a guarantee (or other forms of financial assistance) to the purchaser. A company is not prohibited from giving financial assistance for the purpose of an acquisition of shares in its holding company, if the holding company is incorporated outside Hong Kong.

A guarantee will not extend to a primary obligation which has been materially amended. In the absence of express agreement to the contrary, the guarantee will be discharged and the guarantor will be released. Consent to such amendment may be given in the guarantee itself, or contemporaneously with the amendment. Recent case law from England and Wales (which

might be considered and/or applied by the Hong Kong courts) suggests that a guarantor will not be released from a guarantee where there has been a material change to the underlying agreement guaranteed, if the guarantor had notice of, and has consented to, the change.

A guarantee may also be set aside by the court if the guarantor subsequently becomes insolvent and the guarantee was provided within a certain period of time prior to the commencement of liquidation of the guarantor (see section 5.2).

3.2 What regulatory or other consents are required to grant downstream, upstream and cross-stream guarantees (other than board/shareholder approvals)?

None.

3.3 Briefly outline any enforceability concerns associated with the granting of downstream, upstream and cross-stream guarantees that lenders should be aware of (eg any exchange controls or similar obstacles).

None. However, failure to comply with the conditions, restrictions and limitations set out in section 3.1 may lead to enforceability issues.

Section 4 – Enforcement

4.1 Do the local courts generally recognise and enforce foreign law-governed contracts?

In general, Hong Kong courts will recognise and enforce a foreign law-governed contract, provided that the relevant foreign law is pleaded and proved as fact in accordance with Hong Kong procedural and evidential rules. Parties to a contract are free to choose any law they wish so long as the choice is clear and unambiguous. Case law has suggested that the choice of law must be legal, bona fide and not against public policy. Contracts that contain a floating choice of law (ie different choices of law for different scenarios) may not be approved by Hong Kong courts.

4.2 Will the local courts generally recognise and enforce a foreign judgment that is given against a domestic company in foreign courts (particularly the New York or English courts) without re-examining the merits of the decision?

Hong Kong courts will recognise and enforce foreign judgments where reciprocal arrangements between Hong Kong and the relevant foreign jurisdiction are in place or by virtue of the rules of the common law.

A judgment obtained from a court in England and Wales or New York would be dealt with under common law and the Foreign Judgments (Restriction on Recognition and Enforcement) Ordinance (Cap. 46). A foreign judgment will be entitled to recognition and enforcement in Hong Kong if: (i) it is for a definite sum of money (not relating to taxes or penalties); (ii) it is final and conclusive; (iii) the foreign court had jurisdiction to grant the judgment according to the common law of the conflict of laws; and (iv) the foreign judgment was not obtained by fraud, does not contravene the rules of natural justice and is not contrary to public policy.

Further, a foreign judgment is enforceable under common law if it: (i) is *in personam*; (ii) is in the nature of a monetary award (as opposed to specific performance or injunctive relief, which may not be enforceable in Hong Kong); (iii) is a final judgment from the relevant foreign court; and (iv) the defendant has submitted to the jurisdiction of the foreign court.

A foreign judgment may not be enforceable where a party claims that it enjoys state immunity. The Court of Final Appeal of Hong Kong held that the conferring or withholding of state immunity is a matter of foreign affairs, which depends on the state's constitutional allocation of powers. The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China sets out the allocation of constitutional responsibilities, such that the independence of judicial power vested in Hong Kong does not encompass acts of state such as foreign affairs. The doctrine of state immunity

to be applied will therefore be deferred to the Central People's Government.

4.3 Will the local courts recognise and enforce an arbitral award given against the company without re-examining the merits of the decision?

Under the Arbitration Ordinance (Cap. 609), arbitral awards made in any state or territory of a state that is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards are enforceable in Hong Kong. There are also reciprocal recognition and enforcement agreements between Hong Kong and both Mainland China and Macau (reciprocal agreements).

Hong Kong courts may refuse to enforce a foreign arbitral award, if: (i) the party against whom the award is made succeeds in proving any of the grounds set out in Sections 86(1), 86(2), 89(2) or 89(3) of the Arbitration Ordinance or those under Article 7 of the reciprocal agreements; or (ii) they find that the award is for a matter which is not capable of settlement by arbitration under Hong Kong law, or that it is contrary to public policy to enforce the award.

4.4 When enforcing security, what factors significantly impact the time such enforcement takes and the value of the proceeds received from such enforcement? For example, are there any statutory requirements such as (a) holding a public auction; (b) court involvement; or (c) obtaining regulatory consents?

Generally, a secured party is not required to seek prior court approval or obtain regulatory consent to enforce its security, although some methods of enforcement (eg receivership, see below) require a court order. A public auction is not statutorily required but may be desirable in order to ensure that the price obtained is defensible.

If a person wishes to appoint a receiver, they must: (i) obtain an order for the appointment of a receiver; or (ii) do so out of court, provided that the relevant security document contains specific contractual provisions to that effect. Such person must, within seven days of the date of the order or of the appointment under those provisions, deliver a statement of that fact to the Registrar of Companies for registration.

4.5 Are there any restrictions that apply specifically to foreign lenders when taking enforcement action?

None.

Section 5 – Bankruptcy and insolvency proceedings

5.1 Briefly, outline the main bankruptcy/insolvency processes in this jurisdiction, including any control or influence that creditors can exert on the process, the timeframes usually involved and any mandatory filing requirements.

There are three main bankruptcy or insolvency regimes in Hong Kong: (i) winding-up or liquidation; (ii) receivership; and, (iii) scheme of arrangement.

Winding-up

The winding-up of a company can either be: (i) by voluntary winding-up by its members or creditors; or (ii) by compulsory winding-up by the court. Winding-up proceedings are commenced by filing a winding-up petition.

Members' voluntary winding-up occurs where a company is solvent and its members pass a resolution to wind-up the company and appoint a liquidator. The directors of the company must issue a certificate of insolvency, stating the company will be able to pay its debts in full within a maximum of 12 months following the commencement of the winding-up.

Creditors' voluntary liquidation occurs where a company is insolvent and its members and creditors pass a resolution to wind up the company and appoint a liquidator.

Compulsory liquidation is made by an order of the High Court after the company or its creditors or contributory file a winding-up petition based on one or more specified grounds (for example, if a company is unable to pay its debts).

Receivership

It is customary for a Hong Kong law-governed security agreement to give the security holder (for example, the security trustee) the right to appoint a receiver. The security agreement should specify how and when (usually after the security created by the security agreement become enforceable) the receiver may be appointed. Generally, the Hong Kong courts are not involved in this process (although they have the power to appoint a receiver if the company is unable to manage its own affairs, or to protect or preserve the property or a company for the benefit of the company's creditors).

Scheme of arrangement

This is a court-approved arrangement between the company and its creditors (with the support of at least 75% in value and 50% in numbers of the creditors in each relevant class) and is typically used if it is not possible or practicable to obtain consent from all of the company's creditors.

5.2 Are there any preference, fraudulent conveyance, clawback, hardening periods or similar issues or preferential creditor rights that lenders should be aware of?

Hong Kong courts may set aside transactions which are entered into by an insolvent company within specified periods of time prior to the commencement of liquidation of that company. The lengths of such periods depend on the underlying transaction. For example, the relevant time period is six months for unfair preferences (two years if a party to the preference is an associate of the company) and three years for extortionate credit transactions. Floating charges created by the company within 12 months of the commencement of liquidation may also be invalid unless it is proved that the company, immediately after the creation of the charge, was solvent.

Lenders should also note that the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) provides that, in a winding-up scenario, certain preferential payments (such as severance and long service payments to employees) will be paid ahead of the claims of the creditors of the insolvent company.

5.3 Do bankruptcy/insolvency processes provide for any kind of stay/moratorium on enforcement of lender claims? If so, does the stay/moratorium apply to the enforcement of security interests?

Hong Kong courts may stay proceedings at any time after a winding-up application has been made. Once a winding-up order has been made, or a provisional liquidator has been appointed, all proceedings (including enforcement proceedings) are automatically stayed. No moratorium is available during receivership or a scheme of arrangement.

Section 6 – Your jurisdiction

6.1 In no more than 200 words, outline any cross-border financing trends specific to your jurisdiction.

Mainland Chinese companies continue to tap the international markets by using offshore entities to borrow or issue bonds in Hong Kong. Regulations issued by the State Administration of Foreign Exchange (SAFE) of the People's Republic of China have been relaxed in recent years, but they continue to restrict the ability of issuers to use cash from the mainland to meet offshore debt payments. Offshore bondholders and lenders often look to structure debt using the *nei bao wai dai* arrangement, which refers to guarantees or security provided by an onshore entity in respect of an offshore financing made available to an offshore debtor. Compliance with the SAFE regulations will remain a feature of cross-border financing deals involving mainland Chinese companies issuing offshore debt.


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