The Lending and Secured Finance Review

Third Edition

Editor
Azadeh Nassiri

The Law Reviews

THE

The Lending and Secured Finance Review

TheThe Lending and Secured Finance Review
Reproduced with permission from Law Business Research Ltd.

This article was first published in The Lending and Secured Finance Review, - Edition 3
(published in September 2017 – editor Azadeh Nassiri)

For further information please email
Nick.Barette@thelawreviews.co.uk

The Lending and Secured Finance Review

Third Edition

Editor
Azadeh Nassiri

The Law Reviews

PUBLISHER
Gideon Roberton

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGERS
Thomas Lee, Joel Woods

ACCOUNT MANAGERS
Pere Aspinall, Sophie Emberson,
Laura Lynas, Jack Bagnall

MARKETING AND READERSHIP COORDINATOR
Rebecca Mogridge

RESEARCHER
Arthur Hunter

EDITORIAL COORDINATOR
Gavin Jordan

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Martin Roach

SUBEDITOR
Charlotte Stretch

CHIEF EXECUTIVE OFFICER
Paul Howarth

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-910813-74-4

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

THE PROJECTS AND CONSTRUCTION REVIEW

THE INTERNATIONAL CAPITAL MARKETS REVIEW

THE REAL ESTATE LAW REVIEW

THE PRIVATE EQUITY REVIEW

THE ENERGY REGULATION AND MARKETS REVIEW

THE INTELLECTUAL PROPERTY REVIEW

THE ASSET MANAGEMENT REVIEW

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

THE MINING LAW REVIEW

THE EXECUTIVE REMUNERATION REVIEW

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW

THE CARTELS AND LENIENCY REVIEW

THE TAX DISPUTES AND LITIGATION REVIEW

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ALLEN & OVERY

ALTIUS

ANDERSON MŌRI & TOMOTSUNE

BONELLIEREDE

BREDIN PRAT

CYRIL AMARCHAND MANGALDAS

DE BRAUW BLACKSTONE WESTBROEK

GOODMANS LLP

HAMILTON ADVOKATBYRÅ

HENGELER MUELLER, PARTNERSCHAFT VON RECHTSANWÄLTEN MBB

KANNAVA, KITROMILIDOU & CO LLC

KPP LAW FIRM

LEE AND LI, ATTORNEYS-AT-LAW

LENZ & STAEHELIN

MAPLES AND CALDER

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

PINHEIRO NETO ADVOGADOS

RAHAYU & PARTNERS LAW OFFICES

SLAUGHTER AND MAY

URÍA MENÉNDEZ ABOGADOS, SLP

VDA VIEIRA DE ALMEIDA

WOLF THEISS RECHTSANWÄLTE/ATTORNEYS-AT-LAW

CONTENTS

PREFACE

This third edition of *The Lending and Secured Finance Review* comes at a particularly uncertain time for the financial markets.

Although the debt markets have been relatively resilient in the face of a series of shocks, the economic outlook remains uncertain: concerns about Brexit, the slow pace of growth in the eurozone, exchange rate movements and the competitive threat posed by deregulation in the US to the UK and European financial markets are among multiple geopolitical risk factors on the horizon.

While none of these factors appears as yet to be having a material or market-wide negative impact on loan documentation terms or availability, lending volumes did decline in 2016/2017 across the broader Europe, the Middle East and Africa (EMEA) region. This decline is generally attributed to a drop in refinancing activity (many borrowers having met their refinancing needs during 2014/2015), lessened demand for event-driven financings (the prospect of Brexit and the election of President Trump, among other factors, having had a chilling effect) and a decline in demand for corporate credit as central bank measures and a low interest rate environment continue to support a good flow of liquidity.

Indeed, the combination of a liquid market and limited demand has meant that many borrowers have been able to achieve favourable pricing and terms. This downward pressure on pricing and terms has been particularly evident in the leveraged market, where pricing has fallen significantly and the incidence of covenant-lite terms has increased materially. More recently, there have been some signs of banks adopting a more cautious approach to lending terms on a deal-by-deal basis, although this has not yet translated into a tightening across the market, and it remains to be seen whether the currently borrower-friendly conditions that are being achieved will continue through the remainder of 2017.

This edition of *The Lending and Secured Finance Review* contains contributions from leading practitioners in 23 different countries, and I would like to thank each of the contributors for taking the time to share their expertise on the developments in the corporate lending and secured finance markets in their respective jurisdictions and on the challenges and opportunities facing market participants. I would also like to thank our publishers without whom this Review would not have been possible.

I hope that the commentary that follows will serve as a useful source for practitioners and other readers.

Azadeh Nassiri
Slaughter and May
London
July 2017

Chapter 1

AUSTRIA

Leopold Höher[1]

I OVERVIEW

The corporate lending market in Austria picked up speed in 2016/2017. Although almost all market participants engaged in the lending business, in particular credit institutions, still need to (and will have to continue to) allocate a fair amount of resources to implement, and comply with, a variety of European and Austrian legislation providing for a strict regulatory framework (such as, for example, increased equity requirements and capital buffers in the context of the particular credit institution's risk position or profile), the supply and demand for loan financing is constantly growing.

Austrian lenders are very active in both the Austrian lending market and (although considerably more sensibly compared with previous years) the Central and Eastern Europe (CEE) lending market, given that several Austrian credit institutions have strong market presence in the CEE region. As far as financings in the CEE region are concerned, Austrian lenders provide financing to Austrian borrowers active in the CEE region and to non-Austrian borrowers located in the CEE region.

Moreover, Austrian lenders' participation in Anglo-Saxon and German syndicated financing transactions comprises a fair amount of their overall lending activity (either with or without the involvement of an Austrian borrower or security provider).

When focusing on the Austrian law financing market, deal activity seems to be growing, while deal volumes remain stable or below pre-crisis level. In particular, deals within low two-digit-million volumes involving mid-market companies are rapidly growing. Also, because of the current borrower-friendly interest rate environment, borrowers are seeking to refinance their existing debt on more favourable and commercially attractive terms.

What we have also recognised is a constantly growing interest of US and UK-based investment funds in the Austrian market generally and in the financing market particularly.

A fair bulk of Austrian law syndicated loan transactions are documented on the basis of the Loan Market Association (LMA) recommended template forms (leveraged or investment grade, as applicable) adapted to meet Austrian law requirements. However, depending on the specific circumstances of the transaction, including the size of the loans made available, the documentation standard used may be fairly shortened compared with the LMA (leveraged) template.

Moreover, the number of non-performing loan transactions in Austria (and also the CEE region) continued to increase in 2016, and this field is expected to become even more active.

1 Leopold Höher is a counsel at Wolf Theiss Rechtsanwälte/Attorneys-at-Law.

Those transactions included sales of Austrian banks in the region, and of non-performing loans and leasing portfolios (e.g., of the bad bank of a former Austrian credit institution active in the CEE region).

II LEGAL AND REGULATORY DEVELOPMENTS

i Certain regulatory aspects with respect to (cross-border) lending business

Lending in Austria generally forms part of a comprehensive list of banking activities enumerated in the Austrian Banking Act. Lending may thus only be conducted on a commercial basis in Austria if the relevant loan provider has been granted an Austrian banking licence or to the extent it is validly passported into Austria under Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.[2] Furthermore, any credit institution authorised in a Member State of the European Economic Area may perform the activities referred to in Nos. 1–15 of Annex I to the European Directive 2013/36/EU in Austria either by the establishment of a branch or by way of the freedom to provide services.

The Austrian Banking Act may also be applicable if the lending activities are conducted from a place outside Austria (i.e., if cross-border activities are carried out).

However, even if not explicitly stated in the Austrian Banking Act, the existence of a lending activity presumes, at least to a certain extent, engagement in the domestic market. Whether a lending business will be considered to be carried out in Austria for the purposes of the Austrian Banking Act may be difficult to determine, as there is no law or regulation to establish the requirements that would have to be fulfilled.

Following discussions in academic literature and decisions rendered by the Austrian Supreme Court and the Austrian Supreme Court in Administrative Matters respectively, there is a non-exhaustive set of factors to be taken into consideration when assessing whether a lending activity is carried out in Austria. The risk that the result of a proposed transaction might be considered to constitute 'lending business' could be mitigated by avoiding any geographical connection to Austria, such as by (1) performing, to the extent possible, any negotiations in the context of the envisaged lending outside Austria; (2) executing and keeping all arrangements concerning the loans outside Austria; and (3) having all accounts relevant in the context of the lending arrangement outside Austria (ensuring, in particular, that any disbursements and repayments are made from, and to, accounts located outside Austria).

Conducting licensable activities (such as lending activities) with respect to Austrian banking law in Austria without a licence could trigger at least administrative fines and civil law sanctions; criminal sanctions may, under certain circumstances, also be imposed. While, however, the transaction (agreement) itself remains valid, monetary penalties may go up to €5 million (or twice of the amount of the benefit achieved). Furthermore, the law provides that whoever carries out the lending activities unlicensed shall not be entitled to any compensation connected with such activities (e.g., interest, commissions, fees); sureties and guarantees granted in connection therewith may be ineffective. Additionally, a civil lawsuit for unfair competition by competitors could be expected.

2 The Capital Requirements Regulation.

Given the increased appetite and presence of funds in the Austrian lending market, regulatory exemptions for the respective regulated activities become more and more important and are a key structuring element of a lending transaction.

ii Basel III implementation

As far as the Basel III framework is concerned, this has been implemented in Austria by a directly applicable European regulation (the Capital Requirements Regulation) and the transposition of the Capital Requirements Directive IV into the Austrian Banking Act, both applicable since 1 January 2014.

Furthermore, several directly applicable Commission-delegated regulations, based on regulatory technical standards drafted by the European Banking Authority, complement this legislative package. Some of the new provisions are envisaged to be phased in by 2019.

The aim of this extensive reform is to strengthen the EU banking sector by introducing higher capital requirements in terms of quality and quantity, new liquidity requirements, improving risk management and governance, and by strengthening banks' transparency and disclosures.

iii Intensification of know your customers (KYC) checks

The core part of the Financial Market Anti-Money Laundering Act (implementing Directive 2015/849 (EU) of the European Parliament and the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing) is applicable as from 1 January 2017. The Financial Market Anti-Money Laundering Act applies, among others, to credit institutions and financial institutions pursuant to the Austrian Banking Act as well as CRR institutions pursuant to Section 9 of the Austrian Banking Act and has a significant impact on, *inter alia*, the KYC checks to be conducted by the respective institutions in relation to their customers. Each such institution is obliged to take appropriate steps to identify, assess and mitigate the risks of money laundering and terrorist financing, taking into account risk factors including those relating to their customers, geographic areas, products, services, transactions or delivery channels and thereby preventing the use of the EU financial system for the purposes of money laundering and terrorist financing.

III TAX CONSIDERATIONS

i Austrian withholding tax

Domestic income from the granting of capital (capital investment) is subject to a withholding tax of 25 per cent or 27.5 per cent under specific circumstances, unless an exemption applies. In a typical loan or credit transaction involving a (domestic or foreign) corporate entity as a lender and an Austrian borrower or an Austrian branch of a foreign borrower, no such withholding tax applies. This is because of the fact that interest from private loans and other non-securitised receivables, which are not based on a bank deposit (or similar banking transaction), is not subject to withholding tax. Furthermore, interest received by a corporate entity that has neither its seat nor its place of management in Austria is not subject to tax in Austria.

In a typical loan or credit transaction involving a (domestic or foreign) corporate entity as a lender and an Austrian borrower or an Austrian branch of a foreign borrower, there are also currently no limitations on the deduction of interest. In particular, Austria has no interest barrier rules. Interest paid to unrelated parties is, therefore, currently fully deductible by the borrower. Note that when the 'BEPS' Directive (Directive EU 2016/1164) will be implemented in Austria (in 2019), interest will likely be deductible only up to an amount of 30 per cent of the EBITDA. Also note that if the lender is a related party of the borrower and the lender is resident in a low-tax jurisdiction, the borrower may not be allowed to fully deduct the interest under current Austrian domestic law.

ii Austrian stamp duty

The Austrian Stamp Duty Act contains an exhaustive catalogue of legal transactions that are in principle subject to Austrian stamp duty, provided that a written document is executed and a specific nexus to Austria exists.

While Austrian stamp duty on loan and credit agreements has been abolished with effect as of 1 January 2011, it is important to note that loan and credit agreements may still be stamp duty-sensitive if they contain or refer to other stamp-dutiable transactions. In the context of loan and credit agreements, such stamp-dutiable transactions typically encompass assignment and transfer agreements (e.g., assignments or transfers by lenders), security assignment agreements, suretyships and mortgages.

The computation of the assessment base is regulated for each type of transaction in the Stamp Duty Act and varies according to the specific conditions of the transaction involved. In general, the stamp duty is calculated as a percentage of the contract value (e.g., the consideration agreed upon or, in the case of security transactions, the secured amount). However, the exact amount of stamp duty due has to be assessed in each individual case.

The Austrian Stamp Duty Act provides for certain exemptions from Austrian stamp duty; for example, an important exemption in the context of debt trading is the exemption from stamp duty for assignments between credit institutions, if the institutions satisfy certain requirements.

Furthermore, all types of transactions that serve to secure a loan or credit agreement (with the exception of bills of exchange, which may, under certain circumstances trigger Austrian stamp duty) may be exempt from Austrian stamp duty. However, to the extent the security is not provided solely for a loan or credit obligation but also for any other further obligation (e.g., a security for a security), that exemption might not apply.

In the case of stamp duty-sensitive transactions, in relation to which no exemption applies, various other schemes to mitigate the risk of triggering Austrian stamp duty are available. An option to mitigate the stamp duty risk that is commonly used in financing transactions is to execute all stamp duty-sensitive documents outside the Republic of Austria and also to keep such documents outside of Austria (it is recommended that stamp duty-sensitive documents also contain a stamp duty-related warning note to strengthen parties' awareness). After execution, the original of the stamp duty-sensitive document and all certified copies thereof must stay outside Austria. Further, documents that refer to stamp duty-sensitive documents and the dutiable transactions (e.g., substitute documentation, notices with respect to the stamp-dutiable transaction or documents signed by either of the parties that refer to the stamp-dutiable transaction) must not be sent to or from Austria.

With respect to standard indemnities by the borrower in respect of, *inter alia*, stamp duty, as foreseen in the LMA recommended template forms, it should be highlighted that under Austrian law all parties to an agreement would be jointly and severally liable for stamp duties triggered, and the Austrian tax authorities are not legally bound by agreements between the parties that deviate from the statutory provisions. However, the tax authority shall, at its discretion, at first approach the party that shall bear any stamp duty that is triggered as agreed between the contractual parties.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Austrian law recognises various types of securities, and lending transactions typically involve pledges over various asset classes, such as, for example, shares, receivables (trade receivables, intra-group receivables, insurance receivables, etc.), bank accounts, real estate and (to the extent applicable in the context of the security package) intellectual property rights.

In the context of structuring an Austrian security package, it is important to note that Austrian law does not recognise the establishment of security interests over a fluctuating pool of assets (i.e., no floating charge). A security may only be valid if the collateral assets as well as the secured obligations are specified, or at least specifiable.

A pledge or mortgage under Austrian law is an accessory right and will, therefore, be subject to the same legal consequences as the secured obligations, meaning that, for example, if the secured obligation is terminated or not valid, the same would apply to the pledge.

Furthermore, a pledge cannot be separated from the secured obligation, which means that it can only be held and enforced by the creditor of the secured obligation. In the context of Anglo-Saxon and German syndicated financing transactions this is typically achieved by the use of (English or German law-governed) parallel debt concepts. As far as Austrian secured lending transactions are concerned, usually a joint-and-several-creditor structure allowing a security agent to hold the security is implemented, pursuant to which the security agent has its own entitlement to the secured claims in its own name and on its own behalf.

Because of its accessory nature, the pledge will cease by operation of Austrian law upon payment (or other discharge) of the underlying secured obligation.

For a (*in rem*) security to be validly established, a public act (perfection step), in addition to an agreement, is required. The steps to be undertaken to perfect the relevant security interest depend on the asset class. The necessary act of publicity for a mortgage is registration with the land register. As far as, for example, pledges over receivables are concerned, either (1) the pledgor has to make a corresponding annotation in its books and accounts or (2) the relevant third-party debtor needs to be notified. In this context, it is important to note that as long as a third-party debtor has not been notified accordingly, the debtor may settle its obligations towards the pledgor with debt-discharging effect by paying to the pledgor.

Since, as outlined above, the concept of a floating charge is not recognised under Austrian law, the creation and perfection of security interests over moveable assets would require the delivery of the collateral assets into the custody of the security agent or a delegate of the security agent acting as custodian. As a result of this requirement and related asset disposition control mechanics that need to be complied with to stand the tests of the Austrian courts, the taking of security over inventory depends on its importance (cost/benefit analysis) in the context of the security package.

In connection with costs associated with the establishment of securities, mortgages, for example, are subject to court fees for registration of the mortgages in the relevant land registers (in principle 1.2 per cent of the secured amount) as well as stamp duties (in principle 1 per cent of the secured amount), unless an exemption pursuant to the Austrian Stamp Duty Act applies (see Section III, *supra*).

ii Guarantees and other forms of credit support

Guarantees are a very commonly used instrument in terms of credit support. Abstract guarantees under Austrian law are characterised by their non-accessory nature, meaning that any obligations under the guarantee remain unaffected by any changes to the underlying (secured) obligations.

However, in that context, despite the abstract nature of a guarantee, the validity, binding effect and enforceability may be limited or otherwise affected by, among others:

a equitable principles of general applicability of Austrian civil law (e.g., the prohibition to abuse legal rights or similar concepts); and

b applicable insolvency, reorganisation, fraudulent conveyance, avoidance, moratorium or similar laws of general application relating to or affecting the enforcement of creditors' rights and remedies.

Thus, while in principle no defences or objections arising out of the arrangements underlying the (abstract) guarantee can be raised by a guarantor, a guarantor may, despite the abstract nature of the guarantee, raise defences and objections arising out of the guarantee agreement itself (if any). Such defences or objections may in particular concern (1) the invalidity of the guarantee agreement, (2) issuance of an inadequate (payment) demand under the guarantee agreement or (3) non-occurrence of the guaranteed event.

Moreover, for a guarantee to create legal, valid, binding and enforceable obligations of the guarantor, the signatures on behalf of the guarantor on the guarantee need to comply with the requirements of Austrian law as to written form, which will not be met by, for example, a fax copy of the guarantee.

In terms of Austrian stamp duty considerations, while suretyships in principle would be within the catalogue of transactions that are subject to Austrian stamp duty, abstract guarantees, if structured carefully, should not trigger Austrian stamp duty as guarantee agreements are not within the scope of legal transactions enumerated in the Austrian Stamp Duty Act. In this respect, the Austrian tax authorities will only treat an agreement as a guarantee for stamp duty purposes if certain prerequisites are met (e.g., if the guarantor agrees to make unconditionally, without recourse to the validity or existence of the secured obligations, any such payment under the guarantee as the counterparty may demand and to waive any objections thereto).

Other instruments of credit support used from time to time in the context of Austrian secured lending transactions are bills of exchange and letters of comfort (which may, depending on the letter's nature, qualify either as a strong or soft letter of comfort).

iii Priorities and subordination

As far as the ranking of (*in rem*) security interests is concerned, generally under Austrian law, the first come, first served principle applies, meaning that the timing of performance of the relevant perfection step is decisive for the ranking between competing security interests, with the earlier security interest being senior in rank to the later security interest.

Since Austrian law security (other than, for example, real estate) is not registered with any public registers but perfection of certain collateral assets is achieved via, for example, notices to third-party debtors, lenders have to rely on there being no encumbrance or negative pledge representations and undertakings provided for by the security provider.

For limitations that may affect the validity, binding effect and enforceability of a security interest, see Section V, *infra*.

Subordination is typically achieved either by structural subordination or by contractual subordination. For purposes of contractual subordination, usually either intercreditor arrangements or subordination agreements are entered into.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Legal opinions issued in Austria in the context of lending and secured lending arrangements contain a set of various legal limitations and qualifications that are typically also seen in other jurisdictions, as well as limitations reflecting various Austrian law specifics.

The key topics addressed in the limitations section usually comprise the following.

i General effects of insolvency proceedings

Any opinion statements rendered are subject to all limitations arising from the laws relating to insolvency, bankruptcy, liquidation, receivership, moratorium and reorganisation, including certain periods before the institution of such proceedings for which a transaction may be contested and other laws affecting the rights of creditors (including secured creditors) generally, including the principle of equitable subordination.

In particular:

a during a period of six months after the opening of an insolvency proceeding against an Austrian entity, agreements may not be terminated except for good cause if the exercise of such rights would endanger the carrying on of the insolvent's business by the receiver and provided the restriction does not constitute severe personal or economic disadvantages to a particular creditor;

b contractual stipulations providing for the right to withdraw from or cancel an agreement or for an automatic termination in the event of opening of an insolvency proceeding against an Austrian entity are not enforceable, if this was the only reason for withdrawing, cancellation or termination of an agreement; and

c security instruments may not be enforceable for a period of six months from the opening of insolvency proceedings if enforcement would jeopardise the continuation of the Austrian entity's business unless, among other things, enforcement is inevitable to prevent the creditor from incurring severe personal or economic damage.

As far as clawback regimes are concerned, pursuant to Austrian law, transactions may be subject to an avoidance claim. General requirements for avoidance are that (1) the challenged legal act took place within a certain 'suspect period' prior to the commencement of insolvency proceedings, (2) the challenged legal action caused a discrimination of the other creditors and (3) the effect of a successful avoidance claim would be to increase the bankrupt's estate. Grounds for avoidance include, among others, (1) intentional discrimination of other creditors, (2) avoidance due to squandering of assets, (3) avoidance due to preferential treatment and (4) avoidance due to knowledge of insolvency.

Further, any power of attorney – even if granted irrevocably – will automatically terminate upon the opening of insolvency proceedings over the relevant entity's assets.

ii Austrian capital maintenance rules

A strict system of protection of capital of companies against undue distribution to its shareholders applies to Austrian corporations and partnerships whose general partners consists merely of corporations. The concept is based on the principle that the entire set of assets of a company should be protected on behalf of the company's creditors. This goal is reached by a set of capital maintenance rules, restricting the possibility of any direct or indirect distribution to shareholders or their affiliates. The most important exception is the right of the shareholders to receive dividend payments that are restricted to the amount of net profits as shown in the approved annual financial statement and not excluded from distribution by law or the articles of association.

Following these aims, a business transaction that provides for any value transfer to a shareholder or a shareholder's affiliates must be concluded on arm's-length terms supported by adequate consideration. In the absence of arm's-length terms, the transaction constitutes an unlawful repayment of capital and thus violates Austrian capital maintenance rules. Unlawful repayment of capital may be justified by specific corporate reasons that are in the best interest of the company. When assessing whether a transaction is entered into on arm's-length terms, one has to take into consideration not only the specific conditions of the transaction, but also whether a third party would ever enter into this specific transaction. In addition, all advantages to the company must be taken into account.

Austrian courts are interpreting this mandatory principle of Austrian law prohibiting repayment of capital from a company to its shareholders broadly. This prohibition also encompasses the granting of security interests by a company to secure a loan granted to its shareholders (upstream security) or to its shareholders' affiliates (side-stream security) without adequate consideration.

The legal consequence of a violation of the Austrian capital maintenance rules is that the received benefit may be null and void. In that respect, limitation clauses, which are usually included in the relevant lending or security agreement, attempt to partly preserve the security interest (or guarantee) in the event that the court concludes that the security interest (or guarantee) violates Austrian capital maintenance rules, so that the amount secured or guaranteed would be reduced to what is permissible under Austrian law. While this approach is market standard in financing transactions, it should be noted that no case law is available to confirm that a limitation clause achieves its desired purpose.

Generally, Austrian capital maintenance rules are applicable in relations between the company and its shareholders. However, a loan agreement or security agreement may be null and void and a recipient of security or a third-party lender may not be able to claim the full amount of its loan and be liable for repayment of monies received if it either knew or by gross negligence did not know that the transaction violates Austrian capital maintenance rules. While there is no general obligation on a lender to verify or investigate this matter, such an obligation exits in cases where there is a strong suspicion that a transaction violates capital maintenance rules.

iii Legal opinion practice

Legal opinions in (secured) lending transactions in Austria are usually provided by lenders' as well as by obligors' legal counsel. Pursuant to good market practice, legal advisers to the lenders are asked to render an enforceability opinion on the relevant financing documentation and legal advisers to the obligors are asked to render the capacity opinion with respect to the (Austrian) obligors involved.

Legal opinions are typically addressed to the agent as well as to the finance parties that are an original party to the finance documentation as of the date on which the opinion is issued. In the context of syndicated financing transactions, opinion counsels are frequently asked to broaden the addressees to cover also persons becoming lenders during primary syndication within a predefined short period as of the execution of the relevant financing agreement. Typically, legal opinions may be disclosed to (but not relied upon by) persons if so required by applicable law, rule or regulation or any competent judicial, governmental or supervisory body or with the prior written consent of the opinion-issuing counsel.

iv Choice of law – submission to jurisdiction

The courts of Austria will uphold and give effect to a choice of law, and a submission to courts of a jurisdiction other than Austria is legal, valid and binding, subject to the qualifications referred to in Regulation (EC) No. 593/2008 of the European Parliament and the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), and is subject to the rules regarding Austrian public policy and mandatory provisions of Austrian procedural law, insolvency law and corresponding applicable European legislation (in particular Regulation (EU) No. 1215/2012 of the European Parliament and the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the Brussels Ia Regulation)) restricting the free choice of courts. Recognition and enforcement of foreign judgments has to be in line with the terms of applicable European legislation (in particular the Brussels Ia Regulation) and is subject to the rules of procedure set out in the Austrian Enforcement Act or other statutory regulations.

VI LOAN TRADING

In Austria, loan participations are regularly traded. Transfers of loan participations are most commonly achieved either by an assignment of rights or by a transfer of rights and obligations by way of assumption of contract, in which case the whole contractual position of the transferring lender would pass to the new lender (Austrian stamp duty issues need to be considered accordingly (see Section III, *supra*)).

In terms of security interests granted in favour of the initial lender, the accessory nature of Austrian law security interests (other than, for example, abstract guarantees) requires that the beneficiary of the security and the creditor of the secured claims be the same person. If security is provided in the context of syndicated facilities, the use of security agent structures allows lenders to trade their debt without the security being adversely affected. However, any replacement of the security agent may result in the legal requirement to repeat certain acts of publicity in relation to the security to ensure that the security interests remain properly perfected in accordance with Austrian law.

Additionally (funded and unfunded) sub-participations can be found frequently.

Any debt trading requires careful structuring because of regulatory requirements. In the context of debt trading, in particular, provisions encompassing banking secrecy rules need to be taken into account. Since Austrian banking secrecy rules are rather strict, these need to have already been considered at the stage of granting the loan, so that trading is not hindered by banking secrecy obligations.

VII OTHER ISSUES

Other issues that may be of particular interest for lenders in the context of (secured) Austrian financing transactions relate to Austrian companies being in financial crisis in accordance with the terms of the Austrian Act on Equity Replacements. In a financial crisis of the company, a loan granted by a qualified shareholder (i.e., (1) a shareholder with controlling participation,

(2) a shareholder with a participation of at least 25 per cent, and (3) any person not holding a participation in the company but having a controlling influence with regard to the company pursuant to the Act on Equity Replacements) is considered to be equity-replacing, as a consequence of which the shareholder who has granted such an equity-replacing loan could not demand repayment until the borrowing company has been reorganised or restructured, any security granted in connection with such loans may not be enforced and in an insolvency proceeding the relevant claims of the lender are subordinated.

Moreover, in the context of clawback regimes, creditors can – also outside insolvency proceedings – use rights of avoidance granted to them by the Austrian Act on Avoidance of Legal Transactions (the Act limiting the rights of avoidance to transactions similar to the ones mentioned in the Austrian Insolvency Act (see Section V, *supra*)). The claim can be filed by any creditor whose claim against the debtor has not been satisfied by the proceedings under the Austrian Enforcement Act or is not likely to be satisfied by such proceedings.

VIII OUTLOOK AND CONCLUSIONS

While we do not see any new legal, regulatory or market developments in the near future that would have a strong impact on the Austrian law loan market, we believe that compliance with European and Austrian legislation providing for strict regulatory frameworks is an ongoing challenge for loan market participants and comes with material (and ongoing) costs assigned to the implementation of the various components imposed thereby. Furthermore, the still continuing restructuring needs of several debtors (in particular in emerging markets where Austrian credit institutions play a very active role) have sharpened lenders' sensibility in general; this sensibility, however, not necessarily leading to the effect that Austrian lenders are more conservative in terms of providing new financings, but decisions whether or not a new financing is provided are carefully considered and well founded in response to the financial crisis. In general, Austrian lenders are very active and, by conducting significant lending business in Austria and the CEE region, are contributing to further stabilisation and growth in Eastern Europe.

Chapter 2

BELGIUM

Kasper Van Landeghem[1]

I OVERVIEW

The volume of credit in Belgium has risen over the past few years. Despite the increased attention given to alternative finance methods, banks remain the main suppliers of credit in Belgium. The National Bank of Belgium (NBB) reported that during the first quarter of 2017 the outstanding amount of used credit (granted to non-financial institutions) is more than €128 billion and the total amount of available credit facilities is more than €177 billion, which is an increase compared to 2016.[2] Febelfin, the Belgian Financial Sector Federation, reported that Belgian companies continue having sufficient access to credit facilities and that the amount of credit granted is currently at a record high.[3] According to Belgian financial newspaper *De Tijd*, interest rates continue to be low, but they slightly increased, which explains why many corporate borrowers have sought to obtain financing by issuing bonds or other debt instruments as such borrowers wish to protect themselves against a potential increase in interest rates; the total amount raised by Belgian borrowers pursuant to bonds or other debt instruments during the first five months of 2017 increased significantly compared to 2016.[4]

In Belgium, banks often use either their own templates to document loans, or, depending upon the loan size and deal structure, LMA-style[5] documents may also be entered into.

The Belgian legislator and government are continually trying to improve access to credit and have adopted new laws and royal decrees regarding alternative finance arrangements, such as raising money through crowdfunding platforms and direct lending by alternative investment funds. The financing of small and medium-sized enterprises may be reviewed and amended during the next year, and a new law on the security rights regime relating to moveable assets is expected to enter into force at the latest on 1 January 2018.

---

1 Kasper Van Landeghem is a managing associate at Altius.

2 NBB, 'CCCR: Credit granted to resident non-financial corporations according to the Central Corporate Credit Register', http://stat.nbb.be/Index.aspx?lang=en&SubSessionId=2225e03c-e3fb-4c9e-891d-d9c4fcaa2dbf&themetreeid=13 (consulted on 26 May 2017).

3 Febelfin, 'Ondernemerskrediet bereikt hoogste punt ooit', 30 March 2017, https://www.febelfin.be/nl/ondernemerskrediet-bereikt-hoogste-punt-ooit (consulted on 26 May 2017).

4 *De Tijd*, 'Bedrijven storten zich massaal op goedkoop geld', 19 May 2017.

5 Loan Market Association.

II LEGAL AND REGULATORY DEVELOPMENTS

Belgian banks are seeking to protect their profits against the implementation of the ever-changing regulatory requirements. For this reason, Belgian loan documentation (both the banks' own templates and the LMA-style documentation) often contain a clause on increased costs that often have the same effect as the increased-costs clause in the LMA templates. Such an increased-costs clause passes the costs resulting from changes in the law or regulation, including the implementation or application or compliance with Basel III or CRD IV, on to the borrowers.

The Belgian law dated 21 December 2013 concerning the financing of small and medium-sized enterprises entered into force in 2014 (the SME Financing Law) and is currently being revised. This law offers certain protection to SMEs since they often have significantly less bargaining power than their professional counterparts: for example, professional lenders must act reasonably and in good faith and they must inform the SMEs adequately about the loan's terms and conditions. The SME Financing Law also contains certain restrictions on break costs. The SME Financing Law's scope is currently unclear. According to the then Minister of Finance, the SME Financing Law does not apply if one of the borrowers is not an SME or if the borrower is part of a group that, on a consolidated basis, does not qualify as an SME.[6] Certain legal scholars, however, argue that the law should be interpreted literally and that one should only look at the criteria at the single company level. The latter interpretation means that more companies will benefit from the SME Financing Law's protection, and the interpretation is probably not in line with the Belgian legislator's intention when adopting the law: namely protecting real SMEs that have very little bargaining power; not the SMEs that form part of a large group and can depend on the experience, know-how and bargaining power of that group when negotiating a credit agreement. It is also uncertain to what extent the SME Financing Law applies to credit agreements governed by foreign law as it is not clear if the SME Financing Law should be considered to be: (1) a regular mandatory provision of Belgian law that cannot be derogated from by agreement;[7] (2) an overriding mandatory provision of Belgian law;[8] or (3) part of Belgium's public policy.[9]

The security rights regime regarding moveable assets is in the process of being modernised. The Belgian law of 11 July 2013 on security interests over moveable assets is expected to enter into force at the latest on 1 January 2018 (the New Belgian Pledge Law).[10] This New Belgian Pledge Law was supposed to enter into force on 1 January 2017, but its entry into force has been delayed. The main feature of this New Belgian Pledge Law is that there will be two methods to perfect a pledge over moveable assets and make such a pledge effective against third parties: either the pledge is registered in the new pledge register (the New Pledge Register) or the pledgor transfers possession over the pledged assets to the pledgee or a third-party pledge holder. The Belgian government is currently setting up the

6 See the Minister of Finance's response dated 27 January 2014 to question 0678-53.

7 Within the meaning of Article 3 (3) of Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

8 Within the meaning of Article 9 of Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

9 Within the meaning of Article 21 of Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

10 At the time of submitting this article (1 June 2017), the New Belgian Pledge Law has not yet entered into force.

New Pledge Register. It will not be possible to make a pledge over receivables or financial instruments (such as registered shares, book-entry shares and cash standing to the credit of a bank account) effective against third parties by registration in the New Pledge Register. Perfection of a pledge over receivables or financial instruments will remain subject to the existing rules. The New Belgian Pledge Law creates a modern security rights regime regarding moveable assets with a very broad scope of application, and will make it much easier to create and perfect a pledge over moveable assets (in particular tangible moveable assets).

In 2016 and 2017, new regulations have been adopted to promote direct lending by alternative investment funds. Such regulations aim to strengthen the financial capacity of start-ups, unlisted companies and growth companies but also to protect the interests of investors. In addition, a new law concerning the regulation of certain crowdfunding platforms was introduced.

III TAX CONSIDERATIONS

i Withholding tax

As a general rule, Belgian tax law provides a withholding tax on interest payments, but certain exemptions apply. For example, Belgian domestic law provides for an exemption from withholding tax on interest payments made by qualifying Belgian companies in favour of credit institutions (banks) located in the European Economic Area or in a state that has concluded a double tax treaty with Belgium.

ii Deductibility of interest for borrowers

Interest paid upon a borrower's loans is tax-deductible provided that certain conditions are met. Generally speaking, these conditions include the following: (1) the lender must be a third party; (2) the borrowed money must be used by the borrower to earn income from its business; and (3) the interest may not exceed market rates (taking into account the specific situation of the borrower).

iii Stamp and documentary taxes

Certain bank documents executed in Belgium, including loan or credit facilities agreements entered into by banking institutions or agreements creating a security interest in favour of banking institutions, are subject to a €0.15 stamp duty.

Mortgage deeds, mortgage mandate deeds and business pledge agreements are subject to various taxes and fees. Pledge agreements that will be registered with the New Pledge Register will be subject to certain registration rights (see Section IV, 'Credit support and subordination', *infra*).

iv FATCA and OECD[11] Common Reporting Standard

Belgium has certain obligations regarding the exchange of information for tax purposes with other countries under the following international acts:

a a Model 1 intergovernmental agreement regarding the Foreign Account Tax Compliance Act signed by Belgium and the United States on 23 April 2014 (FATCA);

11 The Organisation for Economic Co-operation and Development.

b the CRS Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (the OECD Common Reporting Standard); and

c Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

The Belgian law of 16 December 2015 regulating the communication of information regarding financial accounts, by the Belgian financial institutions and the Belgian Ministry of Finance, related to the automatic exchange of information at the international level and for tax purposes has implemented the international acts stated above and provides for a framework for such an automatic exchange of information. Belgian financial institutions, such as banks, falling under the scope of this law will need to report and retain certain information on the reportable accounts held by them to the appropriate Belgian authority, while at the same time protecting their clients' privacy.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Types of security interest

A security interest can be created over moveable assets (tangible and intangible) and immoveable assets (real estate) located in Belgium.

Real estate

A consensual security right over land, buildings or other immoveable property located in Belgium is created by entering into a mortgage deed. Such a mortgage deed must: (1) be executed in Dutch, French or German before a notary; (2) be registered with the tax authorities; and (3) be recorded in the appropriate mortgage registers of each judicial district in which the mortgaged real estate is located (as there is no central mortgage register).

Since the costs associated with a mortgage are very high and calculated on the basis of the amount secured by the mortgage, security providers will often request limiting the amount secured by the mortgage and to cover a significantly higher amount by a mortgage mandate (which is not a security interest, but only a power of attorney to create additional mortgages).

Tangible moveable assets

Specific tangible moveable assets

A pledge over specific tangible moveable assets is currently very difficult to establish in practice and often the validity and enforceability of the specific pledge is not 100 per cent certain. Possession over the pledged assets must be transferred to, and control over the assets must be exercised by, the pledgee or a mutually agreed third party (in which case the pledge agreement will be a tripartite agreement between the pledgor, the pledgee and the third-party pledge holder). Sometimes, the lender hires the services of a specific service provider to perform periodical and physical controls of the pledged assets.

Once the New Belgian Pledge Law enters into force, a pledge over moveable assets may also be perfected by registering such a pledge in the New Pledge Register (therefore, the transfer of possession will no longer be required, but it will remain possible to perfect a pledge by a transfer of possession). As a result, it will become much easier to create and perfect a pledge over specific tangible moveable assets.

Business pledge (floating charge)

The Belgian law of 25 October 1919 on business pledges (the Business Pledge Law) allows creating a pledge over the business of a commercial company. The pledgor retains possession over the assets constituting the business and may sell the assets in the ordinary course of business so that the pledgor can keep on running its business in a normal fashion. The business pledge covers all the assets that constitute the business of the pledgor including, among other things, the clientele, goodwill, commercial name and signs, commercial organisation, trademarks, patents, know-how, rights under leases, furniture, commercial records, equipment and vehicles. Certain moveable assets are only covered if expressly agreed between the parties. Land and buildings are excluded and only 50 per cent of the value of the inventory may be subject to the business pledge. A business can only be pledged if it qualifies as a business as referred to in the Business Pledge Law. A business pledge can only be granted to an entity having an EU banking licence as referred to in Article 7 of the Business Pledge Law.

Since the costs associated with a business pledge are very high and calculated on the basis of the amount secured by the business pledge, security providers will often request limiting the amount secured by a business pledge and covering a significantly higher amount by a business pledge mandate (which is not a security interest, but only a power of attorney to create additional business pledges).

Following the entry into force of the New Belgian Pledge Law, the Business Pledge Law will be abolished. A business pledge that has been validly created and perfected before this entry into force will remain valid and enforceable, but it will lose its rank unless it has been registered in the New Pledge Register within one year after the New Belgian Pledge Law enters into force. This registration can be made in the same way as a new pledge registration, although it is not yet certain which costs, if any, will apply. Existing business pledge mandates will still allow establishing pledges that will be subject to the new rules introduced by the New Belgian Pledge Law.

Intangible moveable assets

Shares and other financial instruments

A pledge over registered shares must be registered in the share register of the company whose shares have been pledged, and this company must be notified of the pledge or acknowledge the pledge.

A pledge over book-entry securities (for example, shares or other financial instruments held through the Euroclear system) is perfected by transferring possession of the shares: the shares must be booked into a specific pledged account held by the pledgee or a person representing the pledgee.

Receivables and bank accounts

A pledge over receivables or bank accounts is only enforceable against the debtor of the pledged receivables or against the account bank once the debtor or the account bank has been notified of or has acknowledged the pledge.

Intellectual property

Perfection of a pledge over intellectual property rights will depend on the type of rights to be pledged: certain pledges must be notified to, or registered with, the relevant IP authorities or registration offices to become effective against third parties.

Security agent

Under Belgian law, certain types of security interest may only be validly created in favour of the creditors of the secured claims and cannot be held by a person acting on behalf of a fluctuating body of creditors. As a result, a Belgian security interest is often created in favour of a security agent acting in its capacity as an independent creditor of a parallel debt. A parallel debt structure is not required regarding a pledge created over financial instruments, such as shares or bank accounts, as such a pledge may be created in favour of a security agent acting as a representative for one or more lenders. Under the New Belgian Pledge Law it will also be possible to grant a pledge over other moveable assets (tangible or intangible) in favour of a security agent acting as a representative for a fluctuating body of lenders.

ii Guarantees and other forms of credit support

Guarantees

There are several types of guarantees available in Belgium, and parties can modify a guarantee according to their needs. For example, a guarantee can be an independent guarantee or an accessory suretyship. A guarantee can also be callable on first demand. A bank guarantee will often be callable on first demand and be independent from the underlying debt documents. A guarantee may also be unlimited or be provided for a maximum amount. Guarantees, especially upstream or side-stream guarantees, will often be limited to lower the risk that the granting of the guarantee would not be within the corporate benefit of the Belgian guarantor (see Section V, 'Legal reservations and opinions practice', *infra*).

Netting and set-offs by the borrower

Given the general rule under Belgian law that creditors should be treated equally upon a debtor's insolvency, a person can no longer set off its debt against the receivable of another person following the insolvency of the latter. There are certain exceptions to this rule: statutory netting may occur if certain conditions are met (for example, the receivables must be closely connected) and contractual netting will, as a rule, also survive the insolvency of one of the parties (unless the netting agreement has been entered into during a 'hardening' period).

The LMA clause that all payments an obligor makes must be made without set-off or counterclaim is generally deemed to be valid under Belgian law.

Negative pledge undertakings

Belgian bank lending documentation will most likely include negative pledge undertakings. Such an undertaking, however, will probably (this is subject to debate) not affect the security interest granted by an obligor breaching such a negative pledge undertaking provided that the beneficiary of the security interest was acting in good faith.

Mortgage mandates and business pledge mandates

Mortgage mandates and business pledge mandates can be used to limit, or at least postpone, the costs related to a mortgage or business pledge. Such mandates are irrevocable powers of attorney to establish additional mortgages or business pledges, but do not create a security interest effective against third parties and do not give any right of priority to the banks. A mandate cannot be used to create a mortgage or a business pledge following the security provider's bankruptcy or during a hardening period preceding the bankruptcy.

iii Priorities and subordination

Priorities

The ranking of creditors is a complex matter under Belgian law. In general, the following principles apply:

a Creditors rank equally, unless a creditor benefits from a lien or a security interest as provided for by law.

b Certain creditors, such as the creditors for certain judicial costs and the creditor for costs made to maintain or preserve assets, benefit from a super-priority lien and will always rank ahead of other creditors.

c Creditors benefiting from a specific lien (for example, a pledge or a mortgage) will rank ahead of the creditors benefitting from a general lien (for example, the tax and social security authorities that benefit from a statutory lien).

d In the case of competing security interests, the security interest that has been made effective against third parties first will often have priority.

Subordination

Subordination can be achieved contractually between creditors, such as through an intercreditor agreement or a subordination agreement. Such agreements are often entered into between the senior creditors, the junior creditors and the debtors. The subordination of claims secured by certain security interests may require that certain formalities are complied with regarding the security interests.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal reservations

Belgian opinions are normally in line with international practice.

Belgian opinions contain various assumptions regarding matters of fact and foreign law. These assumptions include matters of fact relating to the conclusion of an agreement (such as no violation of public order or vitiated consent); the capacity of the Belgian companies entering into the transaction documents (for example, regarding corporate benefit); the assets secured by a Belgian security interest (for example, regarding ownership); financial assistance and the genuineness and accuracy of the examined documents.

A Belgian legal opinion will typically include several qualifications. These qualifications may cover the following subjects: insolvency; corporate benefit and corporate purpose; change of control clauses; the security agent acting as trustee; parallel debt; financial assistance; perfection of security interests; ranking of security interests and other liens; novation; choice of law and choice of forum; recognition of foreign judgments; rules of procedure and enforcement.

We will discuss some of these legal reservations below.

Corporate benefit

A commercial company subject to Belgian law must enter into a transaction with the intent of pursuing profit. This is a rule of public order. Should a company enter into a transaction without the intent of pursuing profit, the entry into such a transaction by this company will be invalid. Whether or not a company intends to pursue profit is a factual matter.

In addition, the directors of a company subject to Belgian law have a duty to act in the company's corporate benefit. If a Belgian company enters into a transaction that does not fall within the company's corporate benefit, the validity of the transaction could be challenged. The rules existing under Belgian law regarding a company's corporate benefit do not contain well-defined guidelines, and the proper application of any such rules depends on the business issues affecting such a company, which can only (and must) be properly assessed by its board of directors. Whether or not a transaction is to a company's corporate benefit is a factual matter.

Although there is very little case law on the matter, it is generally accepted among legal scholars and practitioners that the granting of a guarantee or a security interest by a Belgian company to secure the obligations of another entity may be within the guarantor or security provider's corporate benefit if the following conditions are met:

a the guarantor or security provider itself derives a benefit from the transaction (a group benefit may be taken into account, but a mere group benefit is generally not considered to be sufficient); and

b the risks incurred by the guarantor or security provider (for example, the value of the encumbered assets and the amount guaranteed by the company) are proportionate to (1) the benefit it derives from the transaction, and (2) its financial capacity.

The granting of downstream guarantees or security interests will generally (but not always) present fewer problems from a corporate benefit perspective. It would be more challenging, however, to satisfy the corporate benefit test when granting upstream or side-stream guarantees or security interests. If a Belgian subsidiary is required to guarantee or secure the indebtedness of the other group companies in the context of a group financing, then the amounts guaranteed or secured by the Belgian subsidiary will often be limited to try to ensure that the security interests or the guarantee are proportionate to the Belgian subsidiary's own benefit derived from the transaction and the Belgian subsidiary's financial capacity.

Financial assistance

A Belgian company may not advance funds, grant loans or provide guarantees or security interests to facilitate the acquisition of the shares held in that Belgian company (for example, a Belgian company may not secure the loan that is used by the borrower to finance the acquisition of the shares held in that Belgian company), unless the procedure as set out in Article 329/430/629 of the Belgian Code of Companies is met. This 'whitewash' procedure is very strict and cumbersome and not often relied upon in practice. One of the requirements is that the financial assistance must be paid out of, and cannot exceed, the distributable profits. Given these requirements, in our experience it is often not possible to rely on this procedure.

Change-of-control clauses

The provisions of an agreement that confer or may confer rights to third parties affecting the assets and liabilities of a Belgian company incorporated as a public limited company or a partnership limited by shares, or that create a debt or an obligation of such a company when the exercise of these rights depends on the issue of a public takeover bid on the shares of the company or on a change of the control over the company, must be approved by the company's shareholders. The shareholders' resolutions approving the change-of-control clauses must be filed with the relevant commercial court's clerk's office.

Security agent and parallel debt

As there is no established concept of 'trust' or 'trustee' under the present Belgian legal system, Belgian legal opinions will normally not give an opinion on the precise nature, effect and enforceability in Belgium of the security agent's duties, rights and powers as a trustee or on the performance or exercise of such duties, rights and powers.

As stated above (see Section IV, *supra*), Belgian security interests are often created in favour of a security agent acting in its capacity as an independent creditor of a parallel debt. Although a parallel debt structure is often used and generally accepted by Belgian legal scholars, legal opinions will often include a (light) qualification as to the validity of such a structure as there is no conclusive case law on this matter.

Choice of law

The choice of Belgian or foreign law to govern the contractual aspects of the transaction documents will generally be accepted under Belgian law, subject to certain qualifications. As a rule, these qualifications are derived from Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) or, if the Rome I Regulation does not apply, then the Belgian Law of 16 July 2004 regarding the code on private international law. For example, the application of foreign law may be refused if it is manifestly incompatible with Belgian laws of public policy or effect may be given to overriding mandatory Belgian law provisions.

A security interest will be subject to the laws of the jurisdiction in which the secured assets are located.

Choice of forum

A jurisdiction clause giving jurisdiction to the courts of Belgium or a foreign jurisdiction will generally be accepted under Belgian law, unless an exclusive ground for jurisdiction applies. The applicability of an exclusive ground for jurisdiction depends on several factors including: the subject matter of the proceedings; the chosen forum; and the domicile of one of the parties. An exclusive ground may be found in different legal acts, including the following: (1) Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) (the domicile of the parties is not relevant for this Regulation if parties have agreed a forum); (2) the Lugano convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters signed at Lugano; (3) Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings (or, in respect of insolvency proceedings opened as from 26 June 2017, Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings); or (4) the Belgian law of 16 July 2004 regarding the code on private international law. For example, parties may generally not freely choose the forum regarding proceedings related to: insolvency; the constitution, the nullity or the dissolution of companies or other legal persons or associations of natural or legal persons; the rights *in rem* in respect of a certain property; entries into public registers; or the registration or validity of intellectual property rights.

Recognition of foreign judgments

A final and conclusive judgment handed down by a court of competent jurisdiction outside Belgium is recognised and enforced by the Belgian courts subject to and in accordance with one of the following legal acts (depending on the jurisdiction of the court that rendered the judgment): (1) Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast); (2) the Lugano convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters; or (3) the Belgian law of 16 July 2004 regarding the code on private international law. For example, a foreign judgment will not be recognised or enforced if it is manifestly contrary to public policy in Belgium.

ii Opinions practice

Belgian legal opinions covering enforceability are typically given by lenders' legal counsel. Often, but not always, the Belgian capacity legal opinions will be delivered by borrowers' legal counsel. We have noticed that lenders' legal counsel are more and more required to deliver full legal opinions covering both capacity and enforceability. An exception is being made for legal opinions delivered in the context of a US bond offering, as in that case the issuer's Belgian legal counsel will often deliver the full legal opinion.

VI LOAN TRADING

Loans in Belgium may be traded in different ways, including through novation, assignment sub-participations, securitisation or synthetic methods.

The guarantees or security interests securing a traded loan will, as a rule, continue to exist, but in some cases certain measures have to be taken. For example, if a loan is transferred through novation, liens and mortgages will only continue to exist if the parties have specifically agreed that the liens and mortgages will not cease to exist following the novation. Certain formalities may also need to be complied with such as the registration of the transfer of (1) a mortgage or business pledge with the mortgage registry or (2) a pledge created under the New Belgian Pledge Law with the New Pledge Register.

New lenders and other secondary-market purchasers may benefit from a Belgian security interest through different mechanisms. A Belgian security interest securing a parallel debt will also, indirectly, secure a new lender's participation. The lenders will, however, have a credit or insolvency risk against the security agent that is the creditor of the parallel debt. It is also possible to create a pledge over financial instruments such as shares or bank accounts in favour of a security agent acting as a representative to one or more lenders, including new lenders and other secondary-market purchasers. Following the entry into force of the New Belgian Pledge Law, the security agent will also be able to act as such a representative regarding a pledge over other moveable assets (tangible or intangible).

VII OUTLOOK AND CONCLUSIONS

Professionals dealing with secured lending in Belgium have been looking forward for some time to the entry into force of the New Belgian Pledge Law. It was published in the Belgian State Gazette on 2 August 2013, and its then date of entry into force, which could not be later than 1 December 2014, was to be determined by a Belgian royal decree. This particular procedure was used because of the creation of the New Pledge Register. As the initial entry-into-force deadline approached, this New Pledge Register had not yet been set up, so the Belgian parliament intervened to postpone the original entry-into-force deadline a couple of times; the New Belgian Pledge Law will now enter into force at the latest on 1 January 2018. It is hoped that this time the new deadline will be met as it will increase access to secured lending in Belgium.

Alternative finance methods, such as bond issues or crowdfunding, are hot topics among finance professionals and the Belgian legislator has tried to accommodate such methods. The first five months of 2017 marked an increase in the amount raised by bond issues. However, bank lending is likely to remain by far the most important source of financing in Belgium.

Chapter 3

BRAZIL

Bruno Balduccini and Roberto Panucci Filho[1]

I OVERVIEW

The Brazilian financial system is highly sophisticated and subject to the regulation and supervision of the Central Bank of Brazil. Brazil has faced boom-and-bust economic cycles throughout its history. In the early 2000s, Brazil benefited from rising commodities prices and political stability. As a result, the Brazilian economy grew in size and surpassed the United Kingdom's in 2011. During this period, the local government passed new laws to enhance credit markets (such as the Bankruptcy and Judicial Recovery Law and laws creating new debt instruments and guarantees). As a result, the volume of credit in the Brazilian financial market has grown more than 500 per cent in the past 10 years, reaching 3,105 billion reais at the end of 2016 (1,309 billion to non-financial corporations), which represented 49.6 per cent of Brazilian GDP.[2]

Despite the liberalisation of banking practice in the past decades, local financial institutions still dominate the Brazilian credit market; according to the Central Bank of Brazil, four local banks (Itaú-Unibanco, Bradesco, Banco do Brazil and Caixa Econômica Federal) are responsible for almost 80 per cent of all credit in Brazil. Nonetheless, foreign-owned banks still play an important role in the financial markets, but mainly in the corporate lending activities.

In recent years, however, the fall in commodity prices, high level of government spending and corruption scandals led Brazil into a deep recession, and Brazilian GDP decreased 3.8 per cent in 2015 and 3.6 per cent in 2016. The corruption scandals led to a political crisis, and on 31 August 2016, the Brazilian Senate impeached Dilma Rousseff (who had been elected president for the 2015–2018 term) over charges of using creative accounting techniques to manipulate the government budget. Michel Temer, who was Dilma Rousseff's vice president, is the current president of Brazil, and he is also facing difficulties in office, since he was recently charged with taking bribes. Congress shall vote whether or not to allow the Supreme Federal Court to try him for such charges.

Nonetheless, there is a decoupling of the Brazilian economy and the political turmoil in 2017. After the impeachment of Dilma Rousseff, the administration promoted a shift in course of economy, naming market-friendly Henrique Meirelles as finance minister (Mr Meirelles was head of the Central Bank from 2003 to 2010), strengthening the policy framework based on fiscal responsibility, targeting inflation and showing strong commitment

1 Bruno Balduccini is a partner and Roberto Panucci Filho is an associate at Pinheiro Neto Advogados.

2 Source: Central Bank of Brazil.

to pursuing structural reforms in order to ensure sustainable debt dynamics over time. These efforts have been effective to contain inflation, and the IMF expects Brazilian recession to end this year.[3]

II LEGAL AND REGULATORY DEVELOPMENTS

i Basel III

The Brazilian financial sector can be considered large, solid, sophisticated and heavily regulated. The Central Bank is responsible for implementing the monetary and credit policies drawn up by the National Monetary Council (CMN), to regulate foreign exchange transactions, as well as to supervise financial institutions.

Banking supervision in Brazil is risk-based, intrusive and sophisticated and already had a high degree of compliance with Basel II in the early 2000s. Accordingly, and because of that, Brazilian financial institutions passed through the financial crisis that began in 2008 and are passing through the current recession extraordinarily well.

The CMN and Central Bank have strengthened regulations further in 2013, regulating the implementation of Basel III on a gradual basis. These regulations address, among other aspects:

a the calculation of capital requirements;
b criteria for eligibility of instruments such as Tier 1 or Tier 2 Capital;
c calculation methodology for regulatory capital;
d the introduction of capital buffers; and
e transition periods for the application of new rules.

The Central Bank may reduce or prohibit the payment of dividends by financial institutions that do not comply with these capital requirements.

In 2014 and 2015, the CMN and the Central Bank issued additional regulations related to, among other things, Basel III framework regarding additional core capital required and leverage coverage ratio.

The implementation of Basel III will likely have a limited impact on financial institution and on lending, because the banking system reports high levels of capitalisation, liquidity and profitability.[4] In December 2015, Brazilian banks in general were capitalised above regulatory minimum levels. The average Basel capital adequacy ratio was 17.2 per cent, complying with Basel III standards. The liquidity ratio based on a liquidity buffer or stressed cash flow was also prudentially adequate. The return on equity of the banking system was affected by the recession and decreased to 11.4 per cent per annum.[5]

ii Improvement of debt collection

In recent years, Brazil has passed laws to improve lending, collateral and debt collection. One of the most important factors to enhance debt collection and to increase lending transactions

3 www.imf.org/en/News/Articles/2017/05/18/NA190517Latin-America-and-the-Caribbean-Bouncing-Back-from-Recession.

4 In 2013, the Director of Financial System Regulation of the Central Bank, Mr Luiz Awazu Pereira da Silva, announced that Brazilian banks would not require additional capital to comply with Basel III before 2017 and that Basel III would not impact credit offers in Brazil.

5 Central Bank of Brazil, Financial Stability Report.

has been the reform of the Bankruptcy and Judicial Recovery Law in 2005, since it establishes the priority of bank credits over tax credits and expressly sets forth that certain credits are bankruptcy-remote. The result is a more efficient debt collection process, especially for home loans and vehicle financing.

On 18 March 2016, the new Code of Civil Procedure, which seeks to discourage procrastinating measures and improve legal certainty, shall also reduce legal risk and improve debt collection became effective. The results of this law are not immediate but should be known in the near future as case law develops.

The foreclosure of shares of publicly held companies has recently been enhanced by a collateral system put in place, in January 2016, by the Brazilian Stock Exchange, BM&F BOVESPA.

iii Anti-corruption framework

Brazil has made considerable efforts to improve its anti-corruption framework recently, with the objective to fulfil international commitments undertaken by Brazil in anti-corruption treaties, as well as to address heavy popular pressure after scandals involving politicians. Three improvements have been remarkable:

a Law No. 12,846/2013 (the Anti-Corruption Act);
b Law No. 12,850/2013; and
c stricter prosecution.

Before the Anti-Corruption Act, only individuals could be held liable for corruption. The Anti-Corruption Act became effective in 2014, providing strict corporate civil and administrative liability for wrongful acts against local or foreign public administration. Violations of the Anti-Corruption Act result in:

a fines that range from 0.1 per cent to 20 per cent of the revenues of the company involved in the violation;
b confiscation of assets;
c suspension or partial shutdown of activities;
d dissolution of the legal entity; and
e prohibition from receiving incentives or subsidies from public entities.

The anti-corruption framework was also improved by Law No. 12,850/2013, which created whistle-blower incentives, and by stricter investigation and prosecution by local authorities. In view of the foregoing, Brazilian companies have become more concerned with compliance practices and lenders are aware that violations of the Anti-Corruption Act may have a material impact on borrowers' cash flow.

In recent years, many companies have been subject to corruption investigations in Brazil. Operação Lava Jato (Operation Car Wash), the investigation into corruption in Brazilian state-owned oil company Petrobras, is the biggest corruption scandal in Brazilian history. As the extent of the corruption is unravelled, politicians and contractors investigated in the operation have been benefiting from the whistle-blowing incentives and have entered into plea agreements, implicating other agents involved in the corrupt scheme. The owners of the meat-packing giant JBS recently entered into a leniency deal with prosecutors admitting to have made payments to over than 1,800 politicians over the last 10 years.

III TAX CONSIDERATIONS

This section provides for a high-level summary on the key aspects related to the Brazilian tax regime, generally applicable to cross-border loan transactions, and more specifically to loans granted by foreign entities to Brazilian companies. The tax treatment of loan transactions granted by local banks is more complex and substantially different to cross-border loans.

Under Brazilian tax legislation, foreign loan transactions may be subject to assessment for two main taxes: financial transaction tax (IOF) and withholding income tax (WHT). While the former tax assesses foreign exchange transactions carried out for the inflow or outflow of funds to and from Brazil (with rates varying in accordance with the type of transaction that has caused the entry or exit of funds), the latter is generally levied upon interest payable by the Brazilian party to the foreign lender.

As a rule, the IOF taxpayer in cross-border loan transactions is the Brazilian borrower. Nonetheless, the Brazilian financial institution has the burden to collect the IOF owed by the Brazilian borrower, and pay this tax to the federal government.

For foreign loans granted to Brazilian companies, current IOF regulations determine that a 6 per cent flat rate shall apply on the inflow of funds into the country if the minimum average maturity term of the loan is equal to or lower than 180 days. Otherwise, if a foreign loan is granted for a higher term, the 6 per cent rate upon the entry of the resources into the county is reduced to zero. If the loan enters into the country expecting to comply with the minimum average term for benefiting from the reduced IOF rate, but for any reason the Brazilian borrower fails to meet the minimum requirement, the IOF will be considered as being due at a 6 per cent rate as from the date of the inflow of the corresponding funds, with a 20 per cent late-payment penalty and interest on arrears based on the Special Clearance and Escrow System rate (currently approximately 11 per cent per annum) also being applied.

IOF may also be levied in the event of the renegotiation of loan transactions. Brazilian foreign exchange regulation sets forth that certain types of amendments of the terms and conditions of foreign loans (such as an assignment of credit) require the execution of 'simultaneous foreign exchange transactions' (i.e., foreign exchange transactions that are contractually entered into as though the original loan was repaid and a new loan would be executed between the parties, even though no actual flow of funds would take place). In view of that, it is necessary to assess whether a renegotiation requires a simultaneous foreign exchange transaction and whether IOF is applicable to each part of the transaction. Within certain limits, the IOF can be changed by the Brazilian government at any time, with no need of a prior approval from Congress.

In addition to IOF, the amounts paid as interest abroad are subject to WHT at a 15 per cent rate. There are two main exceptions to this rule:

a if the beneficiary of the interest is on a jurisdiction blacklisted by the Brazilian tax regulation as a tax haven, the applicable rate will be 25 per cent; and

b if the beneficiary of the interest is domiciled in Japan or is a branch of a Japanese bank in other jurisdiction, the applicable rate will be 12.5 per cent.

The Brazilian borrower will be held responsible for withholding and paying WHT upon the interest paid, credited, delivered, used or remitted to the lender. This tax should be discounted from the gross amounts to be paid abroad, so that if the borrower wishes to receive the actual amounts charged without reductions for taxes collected in Brazil, the tax base on the interest payments should be grossed up accordingly.

In principle, interest paid by a Brazilian borrower to a foreign lender on foreign loans is deemed to be tax-deductible for local corporate income tax purposes. Certain limitations apply to transactions entered between related parties, such as Brazilian transfer pricing and thin capitalisation rules.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

This section provides an overview of the common methods of taking securities over different types of assets in Brazil.

In Brazil, the following methods of credit support are available:

a *in rem* guarantees;
b personal guarantees;
c contract bonds;
d standby letters of credit or demand guarantees; and
e avals on promissory notes.

Fiduciary sale or assignment, mortgage and pledge are *in rem* guarantees. *In rem* guarantees create a privilege over the collateral in favour of the creditor, with this being the asset granted in collateral bound to the secured obligation. In such cases, creditors do not have recourse against the guarantor that provided an *in rem* guarantee to collect outstanding amounts after the foreclosure of the collateral, unless agreed otherwise.

The most common types of *in rem* guarantees are the fiduciary sale, mortgage and pledge.

The fiduciary sale is a type of security interest pursuant to which the guarantor assigns to the creditor the title of certain assets. Therefore, the guarantor continues to have the possession of the assets, still being liable for the duties of an escrow agent or bailee, or a trust in relation to them. Title of the asset granted in fiduciary sale is only given back to the guarantor when the latter has fulfilled all of its obligations under the guaranteed credit.

The fiduciary sale was introduced in Brazil in 1965, but the applicable legal framework changed in the early 2000s with the enactment of a new Civil Code and other laws. These modifications fostered the use of fiduciary sale, which is currently one of the main credit support transactions, especially because of its bankruptcy remoteness feature. Since a fiduciary sale entails the transfer of the ownership of the underlying assets to the creditors, the creditors are not exposed to the risks inherent to a guarantor's bankruptcy.[6] That is the main difference between a fiduciary sale and the other guarantees, which do not entail the transfer of ownership of collateral and, therefore, the creditor may be subject to bankruptcy apportionment of the guarantor.

There are two regimes applicable to fiduciary sales. On one side, Law No. 4,728/65 and Law No. 10,931/04 regulate fiduciary sales within the scope of the financial and capital

6 Bankruptcy and Reorganisation Law: assets granted by means of fiduciary arrangements can have their foreclosure suspended for a period of 180 days (stay period) should the judge consider the assets as being 'essential' for the company's activities. An asset may be considered essential if the guarantor cannot perform its activities without it or when the performance of its activities is jeopardised in the absence of the asset. Brazilian courts tend not to hold financial assets and investments as essential asset, but this analysis must always be done on a case-by-case basis, since it depends on the business of the guarantor.

markets, expressly allowing the fiduciary sale of fungible[7] and non-fungible property and credit rights. On the other side, the Brazilian Civil Code applies to fiduciary sales that are not within the scope of the above-mentioned markets. Although the Brazilian Civil Code makes no provision regarding the characteristics of the asset given as collateral in a fiduciary sale, there are precedents of the Brazilian Superior Court of Justice narrowing the fiduciary sale under the Civil Code to non-fungible assets.[8] Since foreign lenders do not qualify as financial institutions under Brazilian law, it is disputable whether or not a transaction with such entities would qualify as a transaction within the scope of the financial or capital markets and, therefore, it is also disputable that such entities could benefit from a fiduciary sale of fungible assets or credit rights.

Pledges and mortgages are also commonly used as collateral in lending transactions, with pledges being applicable to moveable assets and rights (e.g., machinery, inventory, vehicles, credits and shares) and mortgages to non-moveable assets (e.g., real estate). Different from the fiduciary sale, in pledges and mortgages the guarantor keeps the title of the collateral and, therefore, creditors may be affected by the bankruptcy of the guarantor. In addition to that, pledges and mortgages are subject to multiple liens (first, second, third priority or more), therefore, the creditor may not necessarily receive a first priority security interest with respect to a particular asset if the asset has already been encumbered in favour of another creditor. Fiduciary sale is not subject to multiple liens, since it involves a transfer of ownership to the creditor.

Brazilian law does not provide any specific restriction on taking security over all or substantially all of the assets of a debtor or guarantor. Nonetheless, it is not possible to document such a security interest in a single document, since *in rem* guarantees need to be registered before different authorities depending on the type and location of the asset granted as collateral (registration with the competent authorities is a condition for perfection of such security interests).

Brazilian law forbids the creditor to keep or obtain title of collateral in the event of default (prohibition of *commissoria lex*), unless the guarantor grants express consent after the maturity date of the debt or its acceleration. In view of that, if the guarantor does not grant this consent, the collateral should be sold at a public auction, the proceeds of which will be applied to the payment of the principal and interest of the debt, judicial expenses and legal fees, provided that in the case of attachment of quotas or shares[9] requested by a creditor who is not a shareholder or partner (as the case may be) of the company, the company shall be summoned for the purposes of securing the right of first refusal of its shareholders or partners.[10] In any case, the balance amount (surplus), if any, shall be returned to the guarantor.

---

7 Regarded as commercially interchangeable with other property of the same kind.

8 Special Appeal No. 1.101.375, decided on 4 June 2013; Special Appeal No. 346.240, decided on 30 August 2002; and Special Appeal No. 97.952, decided on 6 April 2000.

9 Brazilian law presently in force does not expressly contemplate the creation of a pledge of quotas of a limited liability company. However, such a pledge of quotas has been accepted by Brazilian courts on the basis of provisions of law relating to the pledging of rights, contract rights and Law No. 6,404/76, as amended.

10 In certain cases, the transfer of shares or quotas may be subject to antitrust clearance and if the new, different, owner is a foreign entity, certain formalities before the Central Bank must be observed by the foreign entity.

ii Guarantees and other forms of credit support

Besides *in rem* guarantees, lending transactions may be secured by personal guarantees. Under Brazilian law, a personal guarantee is likely to be perceived as a surety and may be defined as a contract of a person or corporate entity by which one guarantees, in whole or in part, the performance of an obligation of someone else.

In summary, under Brazilian law:

a personal guarantees may encompass the principal amount and ancillary charges (monetary correction, interest and other fees);
b personal guarantees are granted by guarantor and do not require the debtor's prior consent;
c if the personal guarantee is granted by a married individual, consent of the spouse is required; and
d the guarantor has a series of benefits granted by law, which are generally waived by the parties.

Contract bonds are a type of insurance wherein the insurance company guarantees the performance of the insurance taker's (debtor) underlying obligations under the lending agreement by providing the funds for the insured party to contract another company to perform the insured obligations. Local companies or individuals domiciled in Brazil shall take out insurance coverage before local insurers for risks run in Brazil. There are a few exceptions to this rule; for example, local companies or individuals are allowed to take out insurance coverage abroad if the insurance in question is not offered by local insurance companies.

Standby letters of credit and demand guarantees are also used to guarantee loan transactions. Brazilian banks and affiliates of international banks in Brazil in general do not issue standby letters of credit or demand guarantees for local transactions. Such guarantees are usually issued in connection with cross-border transactions or by financial institutions headquartered abroad.

Promissory notes are documents that represent amounts owed. Although promissory notes are not considered additional guarantees for the payment of debts, they are used to represent amounts owed under the lending transaction, and the debt stated in the promissory note may be guaranteed by a third party by means of an aval guarantee. Any legal entity or individual may issue a promissory note or grant an aval guarantee (additional requirements may be applicable if the aval guarantee is granted by individuals).

iii Priorities and subordination

In the event of bankruptcy liquidation, certain credits are excluded from bankruptcy apportionment, such as assets granted in a fiduciary sale, post-petition claims and certain labour claims. After those credits are paid, the balance of the funds received from the liquidation of the assets must be used to pay the pre-petition claims, in accordance with the following order:

a labour-related claims, limited to 150 minimum wages per creditor, and occupational accident claims;
b secured claims, up to value of the collateral;
c tax claims, except for tax fines;
d special priority claims;
e general priority claims;
f unsecured claims;

g contractual penalties and monetary penalties for breach of criminal or administrative law, including tax law; and
h subordinated claims.

Exception is made for a fiduciary sale, which is bankruptcy remote and is, therefore, not subject to this list of priorities.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal reservations

Lending transactions and collateral may be limited by the validity of the underlying obligation, since under Brazilian law guarantees are considered an accessory duty to the underlying obligation, and the nullity of the principal obligation causes the nullity of all the accessories obligations. Such limitations are not applicable to independent guarantees, such as standby letters of credit, demand guarantees and to aval guarantees on promissory notes.

In addition, bankruptcy, governmental intervention, extrajudicial liquidation, insolvency, fraudulent transfer, judicial and out-of-court reorganisation procedures may impact lending transactions and guarantees (an exception is made for the independent guarantees listed above and for contract bonds).

The Brazilian Bankruptcy Law governs the insolvency proceedings involving companies and corporations and provides three procedures to address insolvency situations, as follows:
a judicial reorganisation;
b out-of-court reorganisation or prepackaged reorganisation; and
c bankruptcy liquidation.

Judicial and prepackaged reorganisations are similar, respectively, to Chapter 11 and prepackaged arrangements under the US Bankruptcy Code. Creditors holding pre-bankruptcy claims are subject to reorganisation and generally precluded to enforce their credit rights against the debtor. Initially, claims are also not enforceable during the stay period in a judicial reorganisation proceeding. Further, in a scenario where the plan of reorganisation or prepackage plan is confirmed, creditors will be bound by the plans (payment terms and corresponding rights will be governed by the relevant instrument). In a bankruptcy scenario, creditors are subject to bankruptcy apportionment of the guarantor.

ii Opinions practice

Brazilian law does not require lenders or borrowers to obtain legal opinions to enter into loan transactions, but such documents may be used to ensure that directors and officers have complied with their fiduciary duties, and to provide comfort to borrowers entering into the transaction.

Legal opinions are mainly required in loan transactions involving large amounts, whereas creditors generally request debtor counsel to provide legal opinions on the corporate powers of the debtor entering the transaction; observations on financial covenants with other creditors; and opinions on legality and enforceability of the loan and the relevant collateral or guarantees. Legal opinions are especially relevant if the loan is granted to a distressed debtor, because according to the Brazilian Bankruptcy Law and in the event of bankruptcy of the debtor, certain acts are ineffective with regard to the bankruptcy estate, whether or not the lender was aware of the counterparty's economic and financial distress and whether or not the debtor intended to defraud creditors.[11]

iii Governing law and choice of jurisdiction

Governing law

In rem guarantees of assets located in Brazil must be governed by Brazilian law. Other agreements (including credit agreements secured by *in rem* guarantees of assets located in Brazil) may be governed by foreign law in a contract if there is a connection between the foreign law chosen and the places where the agreement could be enforced or the place where the parties to the agreements are based. Nonetheless, discussions on the applicable law are not broadly, technically and deeply assessed before the Brazilian courts. In the event of litigation in Brazil involving an agreement governed by foreign law, Brazilian courts tend to disregard foreign law and apply Brazilian laws to the case. There is a different scenario if disputes are solved by arbitration, because arbitration law expressly allows parties to freely choose the governing law.

Foreign awards (judicial or arbitral) can be enforced in Brazil without re-examination of the merits of the case, provided the decision is:

a final and unappealable; and
b previously confirmed by the Superior Court of Justice (STJ).

This confirmation generally takes from six to 18 months to be granted, and is available only if the decision fulfils certain formalities and if it does not violate Brazilian national sovereignty; public policy; and good morals and ethics. The STJ does not analyse the merits of the case to confirm a foreign award.

Choice of jurisdiction

Under Brazilian law, courts shall have jurisdiction (in addition to any other valid choice of jurisdiction that may have been made by virtue of contract) whenever:

a the defendant is domiciled in Brazil;
b the obligation has to be performed in Brazil; or
c the fact under dispute has taken place in Brazil.

---

11 The following acts are ineffective with regard to the bankruptcy estate: (1) payment by the counterparty within the bankruptcy legal term (up to 90 days as from the petition of bankruptcy) of debts not yet fallen due, by any means of extinguishment of the credit right, including by discount of the relevant instrument; (2) payment made within the bankruptcy legal term of debts fallen due and enforceable, in any way other than as provided for in the relevant contract; (3) creation of a security interest, including lien, within the bankruptcy legal term, in the case of a debt contracted previously; if the mortgaged assets are given in subsequent mortgage, the bankruptcy estate shall receive the portion otherwise applying to the creditor of the revoked mortgage; (4) acts performed free of charge during the two years preceding the decree of bankruptcy; (5) waiver of inheritance or legacy during the two years preceding the decree of bankruptcy; (6) sale or transfer of an establishment without the express consent of or payment to all creditors existing at the time, if the debtor has not kept sufficient assets to settle his liabilities, unless, within 30 days, there is no opposition by creditors after being duly notified by a court clerk or by an officer of the Registry of Deeds and Documents; and (7) registration of *in rem* guarantees and of property transfer, for a consideration or free of charge, or an annotation of real property made after the decree of bankruptcy, unless there is a previous annotation thereof.

Besides the above, Brazilian courts have exclusive jurisdiction in actions relating to real estate assets situated in Brazil. The parties may agree to submit disputes related to disposable rights to arbitration, but arbitration panels do not have the power to enforce a decision. The enforcement should be carried out by Brazilian courts.

VI LOAN TRADING

Loan transactions may be structured as bilateral loans or as syndicated loans. In both transactions, the agreement with the borrower is generally entered into only by one lender.

In syndicated loans, the lenders that provided the funding may freely trade their participation, providing notice to the syndicate leader. Such transactions impact neither the borrower nor the guarantors. Nevertheless, the substitution of the syndicate leader does impact such transactions.

The sale of the transaction by the single creditor in a bilateral loan or by the syndicate leader in a syndicated loan may be made by assignment of the loan agreement, endorsement of the loan agreement or novation of the loan, depending on the terms and conditions of the original loan. In an assignment of loan, the lender should notify the borrower of the assignment. This should not affect *in rem* guarantees or aval guarantees, but may cause the release of personal guarantees, contract bonds and standby letters of credit depending on the wording of such documents. In an endorsement, all the guarantees set forth in the endorsed document should survive the transaction. On the other hand, novation causes the release of all guarantees.

VII OTHER ISSUES

i Enforcement

In Brazil, loan agreements can be judicially enforced if the debtor fails to comply with its loan obligations. The enforcement may be made through three different types of lawsuit, described below:

a summary or enforcement procedure, where the judge may immediately order payment of the debt and the foreclosure of collateral. This lawsuit is available if:
   - ascertainable through simple calculation, certain and undisputable; and
   - the debt is represented by a document that qualifies as an extrajudicial enforcement instrument under Brazilian civil procedure rules;

b ordinary collection action, whereby the an order of payment of the debt and definitive foreclosure of assets can only be carried out after a final unappealable decision is rendered (which would take from five to 10 years to be issued, depending on the complexity of the underlying credit transaction); or

c monition action, which is similar to a summary procedure if the debtor does not file a defence, and which is similar to an ordinary collection action if the debtor files defence.

In view of those differences, loan transactions in Brazil are usually structured to allow the lender to file a summary or enforcement to collect the debt or foreclose collateral, avoiding time-consuming ordinary collection and monition actions.

ii Agreements using a foreign currency

As a rule, agreements and obligations enforceable in Brazil must state the amounts due in Brazilian currency. Parties may state amounts in foreign currency in certain cases, such as obligations involving foreign parties. Nonetheless, any judgment for payment of a certain debt in foreign currency obtained in Brazilian courts should be payable in Brazilian currency in an equivalent amount on the date of actual payment. In the event of bankruptcy, all credits denominated in foreign currency shall be converted into local currency at the exchange rate prevailing in Brazil on the date of declaration of bankruptcy. In view of that, creditors must be aware that they hold exchange rate risk in the event of bankruptcy.

iii Registration of foreign loans before the Brazilian authorities

Cross-border loan transactions with a tenor greater than 360 days must be registered before the Central Bank registry of financial transactions module (ROF). Registration allows the inflow and outflow of funds relating to the registered transactions and shall be obtained in the name of the parties to the transaction (i.e., the lender and borrower). If the guaranteed transaction is registered before the ROF, the collateral or guarantee should also be registered to allow the guarantor to remit the funds abroad.

In addition to the ROF required by the Central Bank, the Federal Revenue Office requires that foreign entities carrying out transactions be subject to enrolment with the National Register of Legal Entities. To obtain this enrolment, the foreign entity should also be registered with the Companies Register of the Central Bank through the Central Bank Data System.

iv Limitations to lending and secured finance

Brazilian financial institutions are not allowed to grant loans, advances or guarantees; enter into derivative transactions; underwrite; or hold in their investment portfolio securities of any clients or group of affiliated clients that, in aggregate, give rise to exposure to a client or group of affiliated clients that exceeds 25 per cent of their regulatory capital.[12]

Government and government-controlled corporations are subject to borrowing limits and cannot grant guarantees without proper authorisation.

On the other hand, there is no limitation on borrowing by a non-regulated company or on it guaranteeing the borrowings of its subsidiaries or affiliates.

VIII OUTLOOK AND CONCLUSIONS

Lending activity in Brazil will very likely increase in the following quarters with the end of recession (as forecast by IMF) and in view of the 34 infrastructure concession and privatisation programmes launched by the current administration. Such programmes involve investments in logistics infrastructure, privatisation of sanitation and energy companies and were usually

12 For the purpose of this limit, the following public sector entities are to be considered as separate customers: (1) the Brazilian government; (2) an entity controlled directly or indirectly by the Brazilian government that is not financially dependent on another entity controlled directly or indirectly by the Brazilian government; (3) entities controlled directly or indirectly by the Brazilian government that are financially dependent among themselves; (4) a state or the federal district, jointly with all entities directly or indirectly controlled by it; and (5) a municipal district, jointly with all entities directly or indirectly controlled by it.

financed by the Brazilian Federal Development Bank (BNDES), through subsidised funds. Nonetheless, the current administration is reducing BNDES subsidised loans. Without BNDES's subsidised financing, other investors may increase their lending activity in Brazil and reduce the current interest rates.

Chapter 4

CANADA

Jean E Anderson, David Nadler, Carrie B E Smit, Caroline Descours and David Wiseman[1]

I OVERVIEW

i General

The corporate lending market in Canada was very active in 2016, particularly in the merger and acquisitions area, and, overall, activity levels and the average deal size were higher than in 2015. Syndicated loans are frequently used by Canadian borrowers to fund a number of activities, including acquisitions, capital expenditures, dividend recapitalisations, refinancing of existing debt and ongoing operations. Continuing low interest rates, substantial liquidity in the North American market and reasonable credit terms have contributed to the attractiveness of leveraged loans for Canadian borrowers in 2016. However, the prospect of increased interest rates, uncertainty as to the direction of oil and other commodity prices, together with a tightening of credit terms, may negatively affect the level of Canadian lending activity in 2017.

ii Standardised terms

The Canadian Bankers Association has published Model Credit Agreement Provisions to be used in syndicated loan transactions in Canada. The goal of the Provisions was to standardise selected provisions of loan agreements to more easily facilitate secondary market trading and include standard provisions relating to assignments and loan trading. The Provisions are based on provisions prepared by the Loan Syndication and Trading Association, Inc. Use of the Provisions is not mandatory, but they are commonly used in syndicated loan transactions where the administration agent is a major Canadian bank.

iii Recent Canadian deal activity

Deal volume in the Canadian merger and acquisition market in 2016 increased by 2.4 per cent from 2015, with a total of 2,685 deals announced.[2] These transactions totalled C$331.5 billion, a nine-year high for the Canadian market and a 20 per cent increase from 2015.[3] Deal volume in 2016 peaked in the second quarter (with 709 announced deals), declined in the third

1 Jean E Anderson, David Nadler, Carrie B E Smit, Caroline Descours, David Wiseman are partners at Goodmans LLP. The authors would like to thank Ti-Anna Wang of Goodmans for her invaluable assistance during the writing of this chapter.

2 Crosbie & Company, Canadian M&A Publications, online: www.crosbieco.com/who-we-are/m-a-publications. Figures provided were compiled from the 2016 and 2017 quarterly reports, Note: Crosbie & Company sets a minimum deal value of $5 million for inclusion in its data.

3 Crosbie & Company, footnote 2, *supra*.

quarter (with 681 announced deals) and increased again in the fourth quarter and into the first quarter of 2017 (with 693 and 771 announced deals, respectively).[4] Deal value remained strong on the back of a number of mega deals, but increases in mid-market transactions were the driving force behind the surge in activity.[5] There were 55 mega deal transactions in 2016, with a total value of C$255.4 billion.[6] While the real estate sector was the most active industry by deal volume in the second and fourth quarters of 2016, information technology was the most active industry in the first quarter, with 82 transactions announced, and metals and mining was the most active industry in the third quarter, with 94 transactions announced. Energy was the industry with the highest deal value in 2016 (representing 31 per cent of a total Canadian deal value of C$331.5 billion).[7] Overall, 2016 was a strong year for Canadian merger and acquisition activity, with deal value hitting record levels. The market was driven by a record string of pipeline deals by energy firms making foreign acquisitions, including Enbridge Inc's acquisition of Texas-based Spectra Energy Corp for $61 billion.[8] While experts predict that the overall value of outbound transactions will likely fall in 2017,[9] push for growth by shareholders, a weak currency, strong equity markets, low interest rates, healthy corporate balance sheets and an increase in appetite for cross-border transactions are all expected to support an active Canadian mergers and acquisitions market for 2017.[10]

iv Canadian financing sources

Canadian companies continue to finance their operations in a variety of ways. Day-to-day operations and cash management are generally financed with operating loans or liens of credit that are entered into with a company's primary financial institution. Asset-based loans, financed on the security of a company's working capital assets, also continues to be a frequently used source of financing for many Canadian companies, particularly in the manufacturing, distribution and retail sectors. In many cases, a significant portion of the consideration for acquisitions was funded through various types of debt obtained from a variety of sources. Sources include senior secured credit facilities provided by domestic and foreign financial institutions, second lien credit facilities, unsecured credit facilities, streaming arrangements, high-yield notes and mezzanine debt.

II LEGAL AND REGULATORY MATTERS

i Lender-related regulatory requirements

Canadian borrowers regularly obtain financing and leveraged finance products from a broad range of lenders including domestic and foreign financial institutions, private equity and hedge funds and through the issuance of public debt, including high-yield debt. Canadian

4 Crosbie & Company, footnote 2, *supra*.
5 Crosbie & Company, footnote 2, *supra*.
6 Crosbie & Company, footnote 2, *supra*.
7 Crosbie & Company, footnote 2, *supra*.
8 Bloomberg, 'Pipeline Deals Help Push Canadian Takeovers Abroad to Record', 19 December 2016, online: https://www.bloomberg.com/news/articles/2016-12-19/pipeline-deals-help-push-canadian-dealmaking-to-an-all-time-high.
9 Bloomberg, footnote 8, *supra*.
10 Citi and MergerMarket, 'Navigating Changes: Canadian M&A in a period of global upheaval', 31 January 2017, online: https://www.acuris.com/citi-canadian-ma-outlook-2017.

and foreign banks are very active in this area and provide a wide variety of debt products to Canadian borrowers. The key regulatory issue for lenders dealing with Canadian borrowers is whether the lender would be considered a bank for Canadian regulatory purposes. The activities of Canadian banks and foreign lenders affiliated with foreign banks that are carrying on banking business in Canada are subject to regulation under the federal Bank Act. Lenders that are banks or affiliated with foreign banks must obtain the necessary approvals under the Bank Act to establish a presence in Canada, and must comply with certain operational requirements of the Bank Act on an ongoing basis.

Foreign lenders affiliated with foreign banks that do not have a presence in Canada may lend to Canadian borrowers without obtaining regulatory approvals from federal banking regulators if the lending relationship is established in a way that would not involve the lender being viewed as carrying on business in Canada. Generally speaking, a loan that is made by a lender located outside Canada, and that is approved, negotiated and documented outside Canada with payments being made to an entity outside Canada, should satisfy this test.

Without connection to a bank, foreign and other lenders that are not otherwise regulated as financial institutions in Canada (e.g., insurance companies, trust companies and credit unions) do not require any special licences or regulatory approvals to make a loan to a Canadian borrower. Such lenders will, however, be subject to laws of general application that apply to the taking and enforcement of security in certain provinces. For example, a lender may require an extra-provincial licence under provincial legislation to hold and enforce a mortgage on real estate in that province. Lenders that lend on the security of real property may also need to obtain a mortgage brokerage licence under provincial legislation if it is not a financial institution exempted from compliance.

Although not a Canadian regulatory issue *per se*, foreign lenders entering the Canadian market will also need to consider their ability to fund loans in Canadian dollars as many Canadian borrowers require Canadian dollar borrowings.

ii Borrower-related regulatory requirements

The activities of many Canada borrowers are subject to some degree of government regulation, and often a particular government licence or approval is a key component of the borrower's business operations. Lenders to such borrowers should ensure that the borrower obtains all necessary governmental consents required to grant security on its assets to secure the proposed financing and to permit the lender to realise on its security. In addition, any transfer of a regulated borrower's assets (including any applicable licences) as part of the realisation process may well require further governmental approvals, including approval of the proposed acquirer.

iii Canadian anti-money laundering legislation

The Proceeds of Crime (Money Laundering) and Terrorist Financing Act makes it mandatory for certain entities (including lenders) to ascertain the identity of Canadian borrowers and related parties before accepting them as clients, to report a variety of transactions to the Financial Transactions and Reports Analysis Centre of Canada and to maintain certain client and transaction records. These requirements are designed to assist in the detection and deterrence of money laundering and the financing of terrorist activity in Canada and around the world. Lenders should ensure that their due diligence requirements include a request for the information necessary to ensure compliance with this legislation.

iv Basel III

In 2015, the Basel III liquidity rules started to be phased in as part of Canada's commitment to have the rules progressively phased in by 2019. There are two minimum rules for liquidity: the liquidity coverage ratio that has a 30-day horizon, and the net stable funding ratio that has a one-year horizon. Both rules are designed to ensure adequate liquidity for banks during periods of stress. Canada's banks remain among the best-capitalised in the world in terms of quality and quantity of capital.

III TAX CONSIDERATIONS

Canadian tax issues also need to be considered when structuring financing and leveraged finance products.

i Withholding tax

Under the Income Tax Act (Canada) (the Tax Act), interest paid by a Canadian resident debtor to an arm's-length non-resident creditor will not generally be subject to the Canadian withholding tax, provided that the interest is not participating (e.g., contingent or dependent on the use of or production from property in Canada or computed with reference to revenue, profit, cash flow, commodity price or similar criterion or by reference to dividends paid). Where interest is subject to withholding tax under the provisions of the Tax Act (either because it is paid to a non-arm's length creditor or is participating), the terms of an applicable bilateral tax treaty may apply to reduce the rate of withholding tax from the Canadian domestic rate of 25 per cent. Under the provisions of the Canada–US Income Tax Treaty, the rate is reduced to 15 per cent if the interest is participating, or otherwise to zero per cent. Most other treaties reduce the rate of withholding tax on interest to 10 per cent.

Under Canada's 'back to back' rules, additional withholding tax may apply where an intermediary is interposed between a foreign lender and a Canadian borrower, and a high rate of Canadian withholding tax would otherwise apply in respect of payments to the foreign lender.

ii Interest deductibility

Interest is only deductible to a Canadian resident debtor where it meets certain technical requirements set out in the Tax Act. In particular, interest (not in excess of a reasonable amount) is generally deductible on:

a borrowed money used for the purpose of earning income from a business or property; or

b an amount payable for property that is acquired for the purpose of gaining or producing income from a business or property.

Interest payable on financing incurred to fund the acquisition of an asset to be used in the debtor's business should generally be deductible. Similarly, interest payable on financing incurred to fund the acquisition of shares of a company (where there is a reasonable expectation of income from the shares) should also generally be deductible. Where the Canadian resident debtor incurs debt to finance the acquisition of shares, and it then amalgamates with, or winds up, the target company, the interest payable on that debt will generally continue to be deductible (on the basis that the income-producing shares are now replaced with income-producing assets).

iii Thin capitalisation rules

Under the Tax Act, interest payable by a Canadian resident debtor may not be deductible to the debtor, and also may be subject to Canadian withholding tax on an accrual basis, if the Canadian thin capitalisation rules are applicable. These rules generally apply where:

a a non-resident creditor owns or has a right to acquire (or is non-arm's length with a person who owns or has the right to acquire) shares of the debtor representing 25 per cent or more of the votes or value of the debtor's capital stock; and

b the debt–equity ratio of the debtor is in excess of 1.5:1.

The thin capitalisation rules may apply in a situation where financing is undertaken by a non-resident parent corporation that then on-lends the funds to its Canadian subsidiary.

iv Consolidation issues

Canadian resident corporations do not file consolidated tax returns (unlike in certain other jurisdictions, such as the United States). As a result, interest payable by a Canadian resident corporation is only deductible by that particular corporation and can only offset income earned by that particular corporation. Where the taxable income of the debtor corporation is not sufficient to offset the interest deductions, other transactions may need to be undertaken to efficiently use the interest deductions in the corporate group. In particular, when an acquirer incurs debt to finance the acquisition of a target corporation, additional steps (such as the amalgamation of the acquirer with the target) may need to be undertaken to facilitate the deduction of the interest on the acquisition financing against the target's operating income.

v Stamp and documentary taxes

There are no stamp or other documentary taxes in Canada to which loan or securitisation documentation or loan trading documentation might be subject.

vi Foreign Account Tax Compliance Act

Under the US Foreign Account Tax Compliance Act (FATCA), payments made to foreign creditors under Canadian financing or leveraged finance arrangements may, in certain circumstances, be subject to a 30 per cent US withholding tax. Where there is a risk of FATCA withholding, the applicable loan or debt financing instrument will typically require the foreign creditor to provide such documentation as may be necessary for the debtor to comply with its obligations under FATCA and to determine whether the creditor has complied with its obligations under FATCA, or to determine the amount of FATCA withholding tax that will be deductible from payments made under the instrument. A Canadian debtor will typically not provide a gross up to the foreign creditor for amounts deducted on account of FATCA withholding tax.

IV CREDIT SUPPORT AND SUBORDINATION

Secured loans are commonly used in the Canadian debt market to finance working capital, acquisitions and longer-term borrowing needs. The forms of security and quasi-security (such as guarantees) most commonly used in the Canadian market to secure personal and real property assets, as well as the regime for taking security under the Civil Code of Quebec (CCQ) and the common law applicable in the other provinces and territories are discussed below.[11]

i Security

Personal property – tangible moveable property – common law provinces

Each of the common law provinces and territories in Canada has a personal property security statute (collectively, the PPSAs) that is modelled on Article 9 of the Uniform Commercial Code in the United States. Under the PPSAs, tangible moveable property consists of goods, chattel paper, documents of title and investment property. In secured financings in the Canadian market, tangible moveable property normally means goods that are equipment or inventory.

Security in this type of property is created when a debtor grants to the creditor a security interest in that property. The granting clause in the security agreement will expressly describe the collateral that the security interest attaches to. Quite often, secured creditors are given a general security interest that secures all of the debtor's existing and after-acquired personal property, both tangible and intangible.

A security interest in tangible property must be perfected if a creditor is to have priority over the interests of other creditors and third parties. Registration of a financing statement in the province or territory where tangible assets are physically located is necessary to perfect a security interest in those assets. The PPSAs are publicly accessible, searchable databases and a registered financing statement serves as a public notice that a debtor's assets have been encumbered in favour of a secured creditor. The cost to file a financing statement under the various PPSAs is nominal and varies slightly with the length of the filing term. Secured parties must file under the PPSAs in every province or territory where the debtor's assets are located if they wish to be perfected against all of those assets. Certain types of tangible personal property such as chattel paper, instruments, money, documents of title and large goods can also be perfected by possession.

Personal property – tangible moveable property – Quebec

Security over tangible moveable property in Quebec is created by a hypothec. Registration at the Register of Personal and Moveable Real Rights (RPMRR) perfects the hypothec. The cost to register at the RPMRR is nominal and varies slightly with the length of the filing term. No written agreement is needed where a hypothec is taken with delivery (i.e., a pledge). Perfection occurs when the pledged collateral is physically delivered to the pledgee.

Personal property – tangible moveable property – federal jurisdiction

Security in aircraft, ships and most railways is governed in Canada by federal legislation. While security interests in these types of assets can be taken under the PPSAs or the CCQ, secured parties are well advised to consider any applicable federal legislation and to take any additional steps prescribed therein to establish a first-ranking claims on such assets.

11 The common law provinces and territories in Canada are: British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland, Nunavut, the Yukon Territories and the Northwest Territories.

Personal property – intangible property (general) – common law provinces

Intangible personal property includes claims and receivables, contractual rights, intellectual property rights (IP rights) and investment property.[12] Generally, creditors secure intangibles similarly to tangibles, by way of a security agreement and perfection by registration under the PPSAs.[13] The law of the jurisdiction where the debtor is located[14] at the time the security interest attaches governs the validity, perfection and priority of a security interest in intangible personal property.

IP rights are governed by federal legislation in Canada, but these rights are personal property under the PPSAs and are considered intangibles. A security interest is created in IP rights through a grant of security under a security agreement, and is perfected by registration. In addition, it is common practice for secured creditors with a security interest in Canadian trademarks, copyright or patents to file a copy of or notice of the security agreement with the Canadian Intellectual Property Office.

Personal property – intangible property (general) – Quebec

Under the CCQ, the law of the jurisdiction where the grantor is domiciled (i.e., where its registered office is located) governs the validity and perfection of security over intangibles. Intangibles (incorporeal moveable property) such as claims, receivables, contractual rights and IP rights owned by a debtor domiciled in Quebec are secured under the CCQ by way of a hypothec that is perfected by filing in the RPMRR. For monetary claims relating to the credit balance of a financial account, the security thereon may be perfected as a prior ranking security by entering into a control agreement with the bank or other financial entity that maintains the financial account.

Personal property – intangible property (investment property)

Financial assets such as shares and other securities are considered investment property under the PPSAs. Almost all of the common law provinces and territories have a Securities Transfer Act or similar legislation (STAs) that is based on revised Article 8 of the Uniform Commercial Code. The STAs work together with the PPSAs to govern the creation and perfection of security interests in investment property. The CCQ also contains provisions specific to investment property.

Investment property under the PPSAs and STAs includes securities (uncertificated and certificated), securities entitlements, securities accounts, futures contracts and futures

12 The PPSAs expressly exclude an interest in or claim under any insurance policy or annuity contract from their scope. Secured debtors must take steps outside the PPSAs to secure an interest in an insurance policy. The PPSAs do, however, provide that a previous security interest in other secured personal property assets extends to the proceeds of insurance on such assets. In Quebec, insurance policies can be charged by a hypothec.

13 Certain government receivables payable by the federal government of Canada and the provincial and territorial governments cannot be assigned or transferred as security unless secured parties comply with certain conditions prescribed by statute.

14 Generally, under the PPSAs, a debtor is located at its place of business or if a debtor has more than one place of business, where it has its chief executive office. In Ontario, however, new deeming rules for determining a debtor's location under the Personal Property Security Act (Ontario) became effective on 31 December 2015. The new rules determine a debtor's location based on what type of entity the debtor is. For example, provincial corporations are deemed to be located in the province or territory of incorporation or organisation.

accounts. In secured financings in Canada, the type of investment property seen most commonly is certificated securities. A borrower or guarantor would typically pledge the certificated shares it holds directly in a subsidiary to a lender to secure its obligations owing to that lender.

In addition to execution of a security agreement and filing under the PPSAs to perfect an interest in investment property as an intangible, secured creditors can also establish 'control' or possession over such property. Control is the best method for perfecting such an interest as it gives the secured party a higher priority than a security interest perfected by registration alone.

Where investment property is held directly by a debtor, a secured party obtains control of certificated securities by taking possession of the certificates and either taking an endorsement or having the securities registered in its name. For uncertificated securities, control is achieved by either registering the securities in the name of the secured party or by obtaining a control agreement from the issuer of the securities. A control agreement is a tripartite agreement among the issuer, the debtor and the secured party and provides that the issuer agrees to comply with instructions from the secured party with respect to the securities without the debtor's further consent.

Where the investment property consists of securities entitlements held indirectly by the debtor through a securities intermediary, the secured party obtains control by:

a arranging for the securities intermediary[15] to record the secured party as the entitlement holder;

b obtaining a control agreement from the securities intermediary; or

c having a third party obtain control on its behalf.

Real property

The most common forms of security over real estate in the Canadian market are mortgages, debentures, hypothecs and trust deeds. Real estate in the common law provinces and territories includes land (together with buildings and fixtures), airspace above land, crops, forests, non-navigable waters, easements, subsurface land rights, rental income and other profits derived from land and leasehold interests. Real estate under the CCQ includes land; any constructions and works of a permanent nature located on the land and anything forming an integral part of the land; plants and minerals that are not separated or extracted from the land; personal property that is permanently physically attached and joined to an immoveable and that ensures its utility and real rights in immoveable property; as well as actions to assert such rights or to obtain possession of immoveables. Each province and territory in Canada has a real property title registration system. Secured creditors perfect interests in real property by filing a mortgage, debenture, hypothec or trust deed against the title to the debtor's real property. Generally, registration fees for real property mortgages in Canada are nominal. However, in several provinces and territories (Alberta, Newfoundland, Northwest Territories, Yukon Territories and Nunavut) registration costs can be higher as they are calculated based on varying formulas that take into account the principal amount of the mortgage that is being registered. Lastly, it is worth noting that there are several special statutes in Canada that govern most federally regulated facilities such as airports, prisons and major shipping ports, and these should be assessed when taking security involving such facilities.

15 For example, a clearing house, retail investment broker or bank.

Security over all or substantially all of the debtor's assets

Security over all of a debtor's present and after-acquired property is commonly taken in Canada by secured parties. To do so, standard practice is generally to take separate security agreements, some for personal property (for example, general security agreements, stock pledge agreements and sometimes intellectual property security agreements) and another for real property (for example, a hypothec or debenture) that together, encumber all of the debtor's property. While it is possible to secure both real and personal property in single documents such as a debenture, the practice is seen less often in the Canadian market and primarily on real-estate based transactions.

ii Guarantees and other forms of credit support

Guarantees are a common feature of secured lending structures for financings in the Canadian market. Typically, a guarantor (e.g., a parent or corporate affiliate of the borrower) will enter into a stand-alone guarantee with a lender that guarantees the obligations of the borrower to the lender. In the acquisition context it is not uncommon for the obligations of a sole-purpose acquisition entity to be guaranteed by an equity sponsor or controlling parent company. In Quebec, suretyships are used frequently in secured lending.

Financial assistance

Corporate legislation in Canada has eliminated outright restrictions on financial assistance. It is permitted without restrictions of any kind in several provinces, including Ontario, Nova Scotia and Quebec. In other provinces and territories, financial assistance is also permitted generally but is subject to a solvency test or disclosure requirements. This more relaxed regime has provided increased flexibility to lenders in Canada when structuring security packages that include guarantees.

Corporate benefit

There is no corporate benefit requirement under Canadian corporate law statutes. However, a financing transaction that does not provide any apparent benefit to a corporation may be challenged as oppressive by creditors or minority shareholders or may result in an allegation that the fiduciary duties of the corporate directors approving the transaction have been breached. Guarantees supporting the debt of affiliated entities are generally enforceable and valid in Canada as long as the debt is of benefit to the corporate group as a whole.

Agency concept

The concept of agency is recognised in all Canadian jurisdictions and is commonly used in secured loan structures in Canada. Agents are often used to represent lenders in a syndicate or to hold collateral on behalf of lenders.

In Quebec, the agent must be formally appointed as the hypothecary representative for all present and future creditors of the obligations. The deed of hypothec must be executed before a Quebec notary. As the party holding the hypothec, the agent, in its capacity as hypothecary representative, can enforce all of the rights under the hypothec.

Challenging security under Canadian law

Under Canadian law, there are several ways that a creditor or court-appointed officer could challenge security both before or after the commencement of insolvency or restructuring proceedings. Remedies for 'reviewable transactions' are available under federal insolvency legislation and provincial legislation.

In the context of insolvency proceedings, a trustee in bankruptcy[16] can challenge preferences and other transactions at undervalue under the federal Bankruptcy and Insolvency Act (BIA). Under Section 95 of the BIA, a trustee in bankruptcy can challenge a preference – namely a transaction with a debtor or payment made by a debtor that has the effect of preferring one creditor over another and that was entered into within prescribed time periods before insolvency proceedings in respect of the debtor were commenced. If the preference is proven, the transaction or payment is void against the trustee in bankruptcy. Under Section 96 of the BIA, a trustee in bankruptcy can attack transactions between the debtor and persons who gave inadequate consideration for assets, goods or services provided by the debtor within prescribed time periods before insolvency proceedings in respect of the debtor were commenced. Courts can order that transfers at undervalue are void against the trustee in bankruptcy or, alternatively, that the parties to the transfer pay to the debtor's estate the difference between the consideration received by the debtor and the consideration given by the debtor. To the extent that transactions are rendered void as against a trustee in bankruptcy and the property in question has been further transferred, the BIA provides that the proceeds from the transfer of the property shall be deemed to be the property of the trustee. These sections of the BIA also apply (with any necessary modifications) to proceedings under Canada's other major insolvency and restructuring statute, the Companies' Creditors Arrangement Act (CCAA).[17]

Provincial legislation is also available to creditors or trustees to attack preferential transactions. While there are differences among the various provincial statutes, most provinces allow a creditor to attack fraudulent conveyances and unjust preferences.[18] In general terms, fraudulent conveyances are transactions where conveyances of real or personal property are made with the intent to defeat, hinder, delay or defraud creditors or others. Unjust preferences are preferential payments or transactions made when the debtor was in insolvent circumstances, unable to pay its debts or knew it was on the eve of insolvency. Transactions found to be fraudulent conveyances or unjust preferences can be voided as against creditors.

Finally, in almost all Canadian provinces and territories, creditors may use the oppression remedy under provincial corporate law to challenge security given by a corporation. This would involve a transaction where the corporation or its directors effected a result or acted in a manner that was oppressive, unfairly prejudicial to or unfairly disregarded the interests of certain parties (including creditors). Where oppressive conduct is found, Canadian courts have broad discretion to grant any remedy they deem appropriate in the circumstances.

---

16 Where a trustee refuses or neglects to take proceedings after being requested to do so by a creditor, that creditor may make an application to the court for an order authorising it to take the proceedings in question in its own name and at its own expense and risk.

17 In which case, a monitor could challenge preferences and other transactions at undervalue. See Section 36.1(1) of the CCAA.

18 Court-appointed officers and other parties seeking to challenge a transaction or grant of security may rely on these provincial statutes both within insolvency proceedings under the BIA or CCAA and outside such proceedings.

iii Priorities and subordination

Priorities

In Canada, the priority of a claim of a creditor of an insolvent corporation will depend upon the nature of the claim and the insolvency proceedings applicable to the borrower. The enforcement of security may occur in the context of a proceeding under the CCAA or the BIA. An insolvent corporate borrower may reorganise itself under the CCAA or BIA or petition itself into bankruptcy under the BIA.

In a Canadian insolvency proceeding, certain claims may be afforded priority over a secured lender in a court order and the priority of these claims will be determined by the court based on the facts of each case. In addition, certain statutory charges will continue to have priority over a secured lender's claim in a bankruptcy, including claims for unremitted employee source deductions, certain employee claims that are paid by the Canadian federal government under the Wage Earner Protection Act and certain employee and employer pension plan contributions that are due and unpaid. It should also be noted that a number of the Canadian federal and provincial statutory-deemed trust and charges that can prime a lender's security outside a bankruptcy for unpaid amounts, such as vacation pay and sale taxes, will be reversed in a bankruptcy of the insolvent borrower.

In a CCAA restructuring or BIA proposal, generally speaking, the restructuring plan or proposal for the insolvent borrower must provide for the payment of certain employee and other claims unless otherwise agreed by the relevant parties. In addition, the court may grant a charge in priority to the security of existing lenders in the assets of the debtor to secure, among other things, claims of critical suppliers, debtor-in-possession lenders, corporate directors' indemnities, key employee retention payments and professional administration fees.

As noted above, certain pension claims may rank in priority to a lender's security in the event of a borrower's insolvency. The Supreme Court of Canada decision in *Indalex Limited (Re)*,[19] however, has created some doubt as to the priority afforded to the amount of any funding deficiency arising in connection with the wind-up (a wind-up deficiency) of a borrower's defined benefit pension plan. Prior to this decision, it was generally thought that the deemed trust provisions of the applicable pension legislation would not apply to a wind-up deficiency. Although the Supreme Court made it clear that a deemed trust could apply to a wind-up deficiency and that the claim for that amount would be subordinate to a court-ordered charge securing debtor-in-possession financing for the insolvent borrower, the Court did not opine on the relative priority of liens on the accounts receivable and inventory securing indebtedness in existence at the time that a CCAA order is made. Lenders providing financing to a Canadian borrower that has a defined benefit plan registered in Canada or to acquire a target with such a plan should determine whether a deemed trust could apply to a wind-up deficiency under the applicable pension legislation and consider the impact on their security position in the event of an insolvency.

Equitable subordination

Under the US Bankruptcy Code, the doctrine of equitable subordination allows courts to subordinate creditor claims to those of lower-ranking creditors. This extraordinary remedy is typically reserved for situations of egregious conduct on the part of creditors, because it

19 2013 SCC 6 [*Indalex*].

supplants negotiated contractual arrangements between parties. For a claimant to succeed in subordinating a creditor claim, it must demonstrate that the creditor engaged in inequitable conduct, that the conduct harmed other creditors of the bankrupt company or conferred upon the creditor an unfair advantage, and that the subordination is consistent with the remainder of the US Bankruptcy Code.[20]

Although there is no equivalent legislative provision in Canada, recent decisions by Canadian courts have suggested that the doctrine of equitable subordination could potentially be adopted in certain circumstances. In *Indalex*, the Supreme Court of Canada affirmed the 'wait and see' approach it espoused in *Canada Deposit Insurance Corp v. Canadian Commercial Bank*,[21] whereby rather than ruling one way on the doctrine's applicability, it declared that the facts at hand did not give rise to a claim for equitable subordination and left its determination for a later date.[22] Subsequently, in its recent decision in *US Steel Canada Inc (Re)*[23] (*US Steel*), the Ontario Court of Appeal ruled that the CCAA court does not have the jurisdiction under the CCAA to grant the remedy of equitable subordination. The Ontario Court of Appeal, however, left the door open for equitable subordination to apply in a BIA context on the basis that the BIA provides the court with express jurisdiction in equity. Leave to appeal to the Supreme Court of Canada has been granted in respect of the Ontario Court of Appeal's decision in *US Steel*, the appeal for which is expected to be heard in November 2017. In the meantime, there remains uncertainty as to whether and in what circumstances the doctrine of equitable subordination applies in Canada.

Second lien financings

As noted above, a Canadian borrower may incorporate several different types of indebtedness (including second lien loans) in its capital structure. Second lien loans (also known as term B loans) are an increasingly popular source of financing in Canada for acquisitions, recapitalisations and restructurings. Non-bank entities such as hedge funds, private equity funds and distressed debt funds, particularly those based in the United States, are typically the providers of second lien loans to Canadian borrowers. As second lien loans are secured by a lien on all or a portion of the borrower's assets, these loans are generally considered to be a lower risk alternative to mezzanine loans and, accordingly, are less costly than mezzanine or other junior unsecured debt. In addition, as a result of investor demand for the enhanced yields available through leveraged products, second lien loan terms have become more debtor-friendly and a number of borrowers have been able to obtain covenant-lite loans. Often these loans are provided in US dollars so are particularly attractive to Canadian

20 See also *Grant Forest Products Inc. v. The Toronto-Dominion Bank*, 2015 ONCA 570 (*Grant Forest*). In *Grant Forest*, the Ontario Court of Appeal confirmed that a judge presiding over CCAA proceedings has the discretion to permit a creditor to petition the debtor company into bankruptcy, even when the transition to bankruptcy results in a loss of the pension deemed trust and an altering of priorities in favour of a secured creditor. In addition, the Ontario Court of Appeal, although not explicitly upholding the ruling of the lower court that a wind-up deemed trust does not prevail when a wind-up is ordered after the commencement of CCAA proceedings, did distinguish the facts from the *Indalex* case (the wind-up deemed trust under consideration in *Indalex* arose before the CCAA proceedings commenced, whereas in *Grant Forest*, neither of the pension plans were wound up until after the CCAA proceedings commenced).

21 [1992] 3 SCR 558, paragraph 44.

22 *Indalex*, footnote 17, *supra*, paragraph 77.

23 2016 ONCA 662

borrowers with significant US-dollar cash flows that provide a natural hedge to currency exchange fluctuations that could otherwise affect their ability to make loan payments in US dollars.

The respective rights of the first-lien lenders and the second lien lenders will be set forth in an intercreditor agreement. A first lien-second lien intercreditor agreement will certainly include a contractual subordination of the second lien lender's claim to the rights of the first lien lender and restrictions on the ability of the second lien lender to enforce its lien against the common collateral for the loans. The intercreditor agreement may also include provisions addressing the issues set out directly below.

Intercreditor agreements

Lenders have made a broad variety of debt products available to borrowers to finance their operations, acquisitions and other activities. As a result, many borrowers have complex capital structures with several layers of debt secured by liens on the same collateral. For example, a borrower may have a senior term and operating credit facility, hedging obligations, cash management obligations and a second lien term loan secured by liens on the borrower's assets. Lenders in these circumstances will typically enter into an intercreditor agreement that delineates their respective rights, remedies and priorities particularly in a default situation. Canadian courts will generally treat an intercreditor agreement as an enforceable contract between the lenders and uphold its provisions. However, if the borrower in question is subject to an insolvency proceeding, it is possible that the court supervising the proceeding may make an order that is not consistent with the provisions of the applicable intercreditor agreement in exercising its jurisdiction over the matter.

The terms of any particular intercreditor agreement will be influenced by the borrower's creditworthiness and capital structure, the type and terms of the relevant debt, the lender's preferred exit strategies and the general economic environment. The primary purpose of an intercreditor agreement from a senior lender's perspective is to ensure that it is in a position to control the enforcement proceedings with respect to a defaulting borrower until the senior lender is repaid in full or is no longer prepared to continue. Intercreditor agreements also typically include provisions that deal with:

a the relative priority of liens on the collateral;

b the application and turnover of proceeds derived from the collateral, payment restrictions or blockage periods with respect to junior debt payments;

c restrictions on the type and amount of senior debt that ranks prior to more junior debt;

d standstill periods and other restrictions on enforcement proceedings by holders of junior debt;

e access rights to certain collateral;

f restrictions on certain modifications to the terms of each lender's credit documentation;

g refinancing rights; and

h the right of junior debtholders to purchase the senior debt.

Triggers for junior debt payment blockages, the frequency and length of payment blockage periods as well as the right to make catch-up payments once a payment blockage has ceased are often heavily negotiated. The elements and amount of senior debt (including interest rate and fee increases, over-advances, prepayment premiums and hedging obligations) that ranks in priority to the junior secured debt are also frequently the subject of much discussion.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

In syndicated lending transactions in Canada, legal opinions are generally delivered by counsel to the borrower and, where necessary, local counsel in each relevant province or territory. Such opinions typically include corporate opinions; non-contravention and no breach opinions; regulatory approval opinions; share capital opinions; enforceability opinions; and creation and registration of security opinions.

It is not uncommon for lending transactions in Canada to be financed by foreign lenders based in financial centres such as New York or London. This occurs most often when the borrower is foreign or part of a larger cross-border or international corporate structure or where the transaction being financed is a cross-border transaction. Foreign lenders often expressly choose to have their principal financing agreement governed by the law of their home jurisdiction, and to stipulate that any resulting disputes will be governed by that law. In these circumstances, foreign lenders need to understand how choice of law and foreign judgments are treated in Canada and whether consent to jurisdiction clauses are enforceable.

i Choice of law

Generally speaking, in a proceeding in Canada to enforce a foreign law-governed document, Canadian courts will, with limited exceptions, apply the law expressly chosen by the parties, so long as the choice of the foreign law in the agreement is *bona fide*, legal and not contrary to public policy. Canadian courts will apply local law to procedural matters and apply local laws that have overriding effect. In addition, Canadian courts will not apply foreign law if to do so would have the effect of enforcing a foreign revenue, expropriation or penal law.

In the unlikely event that the parties do not expressly choose a system of law to govern the primary financing agreement, Canadian courts will apply the law that has the closest and most real and substantial connection to the agreement.

ii Enforcement of foreign judgments

Without reconsidering the merits, and subject to certain defences, Canadian courts generally will issue judgments in Canadian dollars based on final and conclusive foreign judgments rendered against the person for a specified amount if the action in Canada is brought within any applicable limitation period. Under certain circumstances, our courts have the discretion to stay or decline to hear an action based on a foreign judgment. Such actions may also be impacted in our courts by bankruptcy, insolvency or other similar laws affecting creditors' rights.

Certain defences are available to debtors in Canada to prevent recognition and enforcement of a foreign judgment against them. The foreign judgment cannot have been obtained by fraud or in a manner contrary to natural justice. In addition, the foreign judgment cannot be for a claim that under Canadian law would be characterised as being based on a revenue, expropriation or penal law, nor can the foreign judgment be contrary to public policy. Finally, our courts will not enforce the foreign judgment if it has already been satisfied or is void or voidable under the foreign law.

iii Submission to jurisdiction clauses

Agreements to submit all disputes related to the financing transaction to a specified jurisdiction are common in commercial financing agreements, and can be exclusive or non-exclusive. Under Canadian law, non-exclusive jurisdiction clauses have historically been held to be enforceable. Recent Canadian case law, including decisions from the Supreme Court of Canada, has strongly supported enforcement of exclusive jurisdiction clauses to increase predictability and certainty in the Canadian market.

VI LOAN TRADING

In Canada, the market for syndicated loans continues to be the primary means for borrowers to access financing. Syndication continues to be the avenue used by lenders to allocate and distribute exposure to certain borrowers or industry sectors. However, unlike the US loan market, the use of secondary trading in loans is limited and there is no significant market for loan participations. Syndication or assignments of loans and lending commitment are the most common methods of transferring loan exposure in Canada. Assignment by a lender of its loan position is usually permitted, subject in some cases to the borrower's consent or only to a permitted list of assignees and to the general requirement that the assignment must not result in increased costs to the borrower. Because of the lack of a significant secondary market for trading loans that limits term B loan availability in Canada as stated above, many large Canadian companies have instead chosen to access the term B loan market or the second lien loan market available in the United States.

Loan participants in Canada, as in most other markets, do not have a direct contractual relationship with the borrower. While a participant assumes the risks associated with the loan transaction in which it is participating, it has no direct interest or rights under any credit documents, including the security, if any, related to the loan. In addition to the credit risk associated with a borrower, a participant also faces the risk related to the solvency of the grantor of a participation in a loan. In the event the grantor of a participation files for bankruptcy, for example, a participant's right to receive payment on its underlying loan will continue to depend upon and flow through the grantor and not the borrower. The terms of the particular participation agreement will determine the rights available to the participant in a grantor's bankruptcy as a secured or unsecured creditor.

VII OUTLOOK AND CONCLUSIONS

We expect that leveraged financing in Canada will be negatively impacted in the coming year to a certain extent by expected increases in interest rates, slow economic growth, continuing weakness in the oil and commodities sectors and a general tightening of credit terms. Having said that, we also expect that Canadian borrowers will continue to take advantage of interest rates that continue to be low by historical standards, where appropriate, by securing debt financing to fund acquisitions, dividend recapitalisations and other balance sheet restructurings and to refinance existing debt with more onerous terms. In addition, we expect that the trend of Canadian borrowers amending (including repricing) and extending their credit facilities prior to maturity will continue given the relatively favourable pricing conditions in the Canadian debt market, particularly in light of the fact that interest rates generally are expected to increase later in 2017.

The high-yield market in Canada has seen increased volume year over year, with eight issuances in 2016 and six issuances to date in 2017.[24]

24 Retrieved from Bloomberg database under Fixed Income Search, with criteria of Canadian dollar-denominated and high-yield based on S&P Issuer Ratings or Moody's.

As US sponsors become more active in Canada and seek financing from Canadian lenders for their Canadian acquisitions, covenant-lite loans are becoming more common in Canada. Covenant-lite loans generally do not include financial maintenance covenants or include them only on a springing basis based on certain leverage levels. Equity cures of financial covenant breaches are generally permitted. As financial covenant breach is often an early indicator of financial difficulty, the downside for lenders is that they may not be able to trigger a default based on a financial covenant breach and initiate restructuring discussions at an early stage when more options are available to address the borrower's financial issues.

Unitranche lending has also gained some popularity with Canadian borrowers, particularly those exposed to US lenders through their US affiliates. Unitranche facilities combine senior and junior debt into one credit facility, with the lenders addressing their respective priorities with a first-in, last-out mechanism under an agreement among lenders.

Another trend is the increased activity level of foreign lenders in Canada, particularly those based in the United States. The increasing level and size of cross-border transactions has created new lending opportunities for foreign lenders in Canada. Many foreign lenders are also seeking to expand their relationship with clients in their home jurisdictions to affiliates of those clients located in Canada. In this connection, a number of foreign lenders have established a local presence in Canada such as a foreign bank branch, and are offering a wide variety of financial products to Canadian clients. The increased competition in the Canadian financial market resulting from entry of additional foreign lenders should be beneficial to Canadian borrowers.

Chapter 5

CYPRUS

Kannava, Kitromilidou & Co LLC[1]

I OVERVIEW

Paramount to any description of the corporate lending market in Cyprus is an understanding of its role as an international financial centre. With one of the most beneficial tax regimes in the EU, a vast network of bilateral tax treaties, a comprehensive legal system fully harmonised with EU law and its highly educated and skilled workforce, Cyprus has, for the past decades, established itself as an international business hub, where numerous international businesses and high net worth individuals, predominantly from Russia and other Member States of the Commonwealth of Independent States, base their corporate and trust structures for tax efficiency, asset protection and other legitimate commercial benefits. Because of, *inter alia*, the adoption of a tax tonnage system, Cyprus is also a major shipping jurisdiction. What is more, Cyprus is now increasingly becoming a financial services jurisdiction, having more than 200 EU-licensed investment firms basing their worldwide operations on the island.[2] Accordingly, the corporate lending market in Cyprus can be described as being divided into two major categories: on the one hand, the corporate lending activities that fuel the Cyprus economy, involving local financial institutions and local corporate borrowers; and on the other hand, the voluminous and heavily varied corporate lending activities of major international financial institutions, private wealth and multinational corporations, which conduct lending activities through Cyprus corporate entities whose underlying assets and business activities are offshore.

In terms of the local aspect of corporate lending to non-financial corporations, which is a market of approximately €22 billion,[3] there was almost no activity in the first years following the collapse of the Cyprus banking industry back in March 2013, caused predominantly by the sovereign debt crisis and resulting in a bail-in and consequent haircut for depositors and a rigorous austerity programme that was imposed by the troika, made up of the European Commission, the International Monetary Fund and the European Central Bank (ECB). As a result, the priority concern of the majority of the local banks was to survive the heavy scale of non-performing loans, at times reaching 50 per cent,[4] through capitalisation and

1 This chapter was written and reviewed by lawyers in the corporate and commercial department of Kannava, Kitromilidou & Co LLC.

2 Cyprus Securities and Exchange Commission list of licensed investment firms as at 6 June 2017 (226 in total) – via the website of the Cyprus Securities and Exchange Commission.

3 Central Bank of Cyprus, 'Monetary and Financial Statistics', April 2017.

4 Central Bank of Cyprus, 'Publication of data on Non-Performing Facilities'. The Central Bank of Cyprus published data on 'Aggregate Cyprus banking sector data (non-performing facilities data)' as at 31 January 2017 – showing the total non-performing facilities at 47 per cent.

reform, thus leaving no room for further lending activities. Within a couple of years, Cyprus has managed to exit the imposed bail-out programme without even utilising the full loan amount, has returned to positive growth with promising projections and has also returned to the capital markets. Taking also into account moves by the ECB to incentivise economic activity, such as qualitative easing and negative interest rates, we are now seeing local banks lending again, albeit cherry-picking credible borrowers and always making sure they have ample security in real assets. In this connection, noteworthy are the significant developments recorded in the fourth quarter of 2016 by the Central Bank of Cyprus,[5] namely an increase in net loan demand by both enterprises and households in Cyprus, reflecting the improving economic climate and the Cyprus banks' expectations for an even higher net loan demand by enterprises and households in 2017, mainly driven by the generally low level of interest rates and the increase in consumer confidence. The most important volume of corporate lending transactions though continues to be in terms of debt restructuring. The revised legal and regulatory regime, adopted as part of the conditions imposed by the troika lenders, assisted considerably in the debt restructuring of approximately €13 billion[6] in loans, with all major local banks focusing their efforts on converting 'red' loans of major corporate lenders into 'black', especially in the construction industry. The transaction documents for this corporate lending activity are for the most part standardised and the nature of the security required is, for the significant majority of cases, real estate mortgages together with fixed and floating charges, in the form of debentures and personal guarantees.

On the international corporate lending front, the Cyprus entities involved – customarily in their capacity as holding companies of groups with worldwide activities – often act as borrowers or guarantors, and in some cases they consequently also act as intra-group lenders. Third-party lenders in such finance transactions are typically major financial institutions originating from the jurisdiction where the underlying assets and activities of the borrower group lie, but there could also be other institutional lenders and private investors. The amount of monies lent on such transactions are often in the tens of millions of euros per transaction, but because in most cases there is no Cyprus banking institution involved and given also that there is no recording requirement for such transactions in Cyprus, the exact amount of this market is hard to identify. This kind of lending transaction can take a variety of forms, ranging from simple loan facilities to repo transactions under the Global Master Repurchase Agreement. They are almost always secured and the documentation used varies significantly; however, the governing law is typically either English law or the law of the jurisdiction where the underlying activities of the parties lie. In what perhaps could be said to be the consequence of de-offshorisation initiatives worldwide and especially in Russia, the trend again lately is for the refinancing or extension of lending facilities granted to existing borrower groups rather than for new corporate lending activities.

5 Central Bank of Cyprus Bank Lending Survey January 2017.

6 Central Bank of Cyprus published data on 'Aggregate Cyprus banking sector data (non-performing facilities data)' as at 31 January 2017.

II LEGAL AND REGULATORY DEVELOPMENTS

i Laws on enforcing mortgages granted as security

In light of its efforts to rescue and revive its economy, and as part of the conditions imposed by its troika lenders, Cyprus has recently passed a new foreclosure legislation framework,[7] which allows for the speedy sale of collateral in bad loans, replacing the old legislation under which the repossession procedure could take up to 15 years. Legislation No. 142(I)/2014 amended the Immoveable Property (Transfer and Mortgage) Law of 1965 (the Law), by allowing a mortgagee to proceed with the sale of the mortgaged property without having the obligation to file a relevant application to the Director of the Land Registry, as it was the case prior to the amendment.[8] Accordingly, if the mortgaged debt is overdue for a period of not less than 120 days,[9] the mortgagee can serve a notice and a statement of account on the debtor and any other interested party informing them that the sale procedure of the mortgaged property has commenced and inviting them to pay off the debt within 30 days of the date of receipt of the notice. If the debtor fails to comply with the first notice, the mortgagee may serve a second notice on the debtor and any other interested party, informing them, that the mortgaged property will be sold at an auction. It is possible for the debtor or any other interested party, within 30 days of receipt of the second notice, to file an appeal to the relevant district court to set aside the notice.[10]

Bank of Cyprus, the island's largest lender, proceeded since the summer of 2016 with the foreclosure of a number of properties worth over €2.3 million, thus, signalling the first auctions under the new foreclosure legal framework. No residential properties were included in the first wave of auctions, and although a few properties were sold, in general little interest was shown in the Cyprus property auctions. Bank of Cyprus and other Cyprus banks are, nevertheless, expected to continue auctions as they rely heavily on the implementation of the foreclosure legislation because it lays the groundwork for large-scale loan restructurings and improves the banks' recovery prospects. The aforementioned legislation is complementary to the restructuring of the insolvency framework under legislation[11] introduced in April 2014 on, *inter alia*, amendment of the corporate bankruptcy framework through the introduction of creditor protection by the court, the licensing of insolvency practitioners and the introduction of protections against foreclosure of primary residences.

---

7 *Inter alia*, amendments were made to the Immoveable Property (Transfer and Mortgage) Law of 1965, Law No. 9/1965; Immoveable Property (Tenure, Registration and Valuation) Law, Cap. 224; Central Bank of Cyprus Laws of 2002–2014, Law No. 138(I)/2002; Civil Procedure Law, Cap. 6 and to other legislation.

8 Part VIA, 'Sale of mortgaged property by the mortgagee' of the Law.

9 Article 44B(1) of the Law.

10 Article 44C(3) of the Law specifies the possible grounds for appeal, namely: (1) the notice does not comply with the required conditions regarding form and content; (2) the notice was not duly served; (3) the notice was sent before the expiry of the deadline for the payment of the debt to the mortgagee (in less than 120 days) and (4) proceedings are pending before the court regarding the first notice that was sent.

11 The Insolvency of Natural Persons (Personal Repayment Schemes and Debt Relief Order) Law of 2015 as amended; Bankruptcy (Amending) Law of 2015; Companies (Amending) Law (No. 3) Law of 2015, regarding liquidation; Companies (Amending) Law (No. 2) Law of 2015, regarding a Protection Mechanism for Restructuring Corporate Debt (Examinership); Insolvency Practitioners Law of 2015, as amended.

ii Anti-money laundering and terrorist financing

Cyprus, as a full member of the European Union, implemented the EU Anti-Money Laundering Directives by passing the Prevention and Suppression of Money Laundering Law of 2007 (AML Law).[12] The Advisory Authority for combating money laundering, a body established under the AML Law,[13] released in mid-May 2017 a first draft of an amended bill for the implementation of the Fourth Anti-Money Laundering Directive[14] (4AMLD), which will be finally amended by the Fifth Anti-Money Laundering Directive aimed at implementing a more strict regulation of virtual currency exchanges (after the Panama Papers fallout). Following a worldwide trend, the recommendations of the Financial Action Task Force (FATF) and the upcoming implementation of the 4AMLD, the regulators of banks, financial service providers, lawyers, accountants and other professional service providers, both on a national and supranational level, continue to impose increasing and rigorous compliance requirements for clients regarding boarding and any sort of movement of funds. This means that currently, in the sphere of corporate lending, any sort of inflow or outflow of funds from or to Cyprus financial institutions, and from or to any Cyprus entity in general, is under the utmost scrutiny with regard to the production of relevant supporting documents and information that identifies the source of funds, the beneficial owner's identity and the underlying commercial rationale of the transaction.

Under the Cyprus legal and regulatory framework, there is currently a requirement to produce supporting documents with regards to as little as a 10 per cent ownership, a threshold that is much more rigorous than the 25 per cent recommended by the FATF and applicable under the EU Directive on money laundering. While such regulations are admittedly a good step towards combating money laundering and financing of criminal activities, in practice they create a huge administrative burden in connection with, *inter alia*, corporate lending transactions and it can often be the case that having to fulfil such rigorous procedures delays sought time frames and otherwise hinders commercial objectives.

III TAX CONSIDERATIONS

i Withholding tax

Under Cyprus tax legislation[15] there are no withholding taxes on flow of funds from and to Cyprus in connection with corporate lending transactions, and there is no withholding tax on payments of interest from Cyprus. Withholding tax on interest paid to Cyprus lenders is governed by the various tax treaties entered into between Cyprus and the paying jurisdiction and thus varies. For interest earned by Cyprus corporations whose ordinary activities are not lending activities, a special contribution for defence tax applies on all interest income at the rate of 30 per cent.[16] As regards back-to-back loans between corporate borrowers, the Cyprus Tax Authorities, taking into account the recent international tax developments, amended the current tax regime in connection with profit margins on loans between related parties. More specifically, as from 1 July 2017, all loans between Cyprus tax-resident companies and

12 The Prevention and Suppression of Money Laundering Law of 2007, Law No. 188(I)/2007.

13 Sections 56 and 57 of the AML Law.

14 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

15 The Income Tax Law of 2002, Law No. 118(I)/2002 as amended.

16 Section 3 of the Special Contribution for the Defence of the Republic Law of 2002, as amended.

their related companies must be supported by a transfer pricing study, which must comply with the OECD principles.[17] Any back-to-back finance transactions remaining in place after 1 July 2017 will also need to be supported by a transfer pricing study for the period from 1 July 2017.

ii Stamp duty

Cyprus stamp duty is levied on documents relating to assets located in Cyprus or matters or things taking place in Cyprus.[18] This includes agreements on corporate lending transactions. Payment of stamp duty on documents does not affect their legal validity; however, any documents that are not stamped with the correct amount of paid duty cannot be adduced in evidence in court without payment of the duty and the appropriate penalty. The wording of the law indicates that the rate of stamp duty is determined by the aggregate value of the contract and is scaled up to a maximum cap of €20,000.[19]

A number of categories of documents are exempt from stamp duty, including documents relating to corporate reorganisations and ship mortgage deeds. Despite the fact that signatories are Cyprus companies, where the matter does not deal with Cyprus-situated property or other things or matters performed in Cyprus it should be exempted from stamp duty. As such, loan agreements, for instance, that are executed in Cyprus but are not utilised in Cyprus, and the monies are paid abroad, will not be subject to stamp duty. On the other hand, pledge of shares of a Cyprus company and mortgages of property of a Cyprus company will be subject to stamp duty. The relevant authority to make such a determination is the Stamp Duty Commissioner, of the Tax Department (formerly the Inland Revenue Department).

Stamp duty must be paid within 30 days from the date of execution of the relevant documents or, if they are executed abroad, within 30 days after they are received in Cyprus. If stamp duty is paid late, there is a surcharge of approximately 10 per cent, which doubles after six months but which cannot exceed €4,000.

iii Foreign Account Tax Compliance Act (FATCA)

The Republic of Cyprus and the United States signed on 2 December 2014 an intergovernmental agreement with regard to FATCA, pursuant to which all participating Cyprus financial institutions are required to report all FATCA-related information to the Tax Department in Cyprus. The Cyprus Minister of Finance issued a relevant decree in order to ensure the effective implementation of the said agreement.[20] FATCA obligations require Cyprus financial institutions to identify financial accounts held by US residents or US citizens, or by entities that are organised in the US or controlled by one or more US persons and to report that information to the US Internal Revenue Service. Financial institutions in Cyprus now ask all clients, existing and new, including borrowers, to fill out self-certification forms and other additional documents in connection with FATCA provisions. Local financial

17 OECD/G20 Base Erosion and Profit Shifting (BEPS) Package.

18 Section 4 of the Stamp Duty Law of 1963, as amended.

19 For transactions with a consideration up to €5,000 no stamp duty is payable; for transactions with a consideration in excess of €5,000 but not exceeding €170,000, stamp duty of €1.50 for every €1,000 or part thereof is payable; for transactions with a consideration in excess of €170,000, stamp duty of €2 for every €1,000 or part thereof is payable.

20 Regulatory Administrative Act 223/2016: FATCA Decree.

institutions did not materially alter lending documentation in connection with FATCA, and even non-financing Cyprus entities acting as cross-border lenders only incorporate FATCA drafting solutions when relevance is identified early on in the due diligence process. Amendments to loan documentation aimed at FATCA compliance predominantly take the form of representations and warranties about the borrower being outside the scope of FATCA, but these can include relevant provisions for allocating the withholding tax risk in the event of non-compliance, such as a gross-up or indemnity provision if the borrower is obliged to make a FATCA withholding.

iv Common Reporting Standard (CRS)

In the context of further improving international tax compliance, Cyprus signed, on 29 October 2014, the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information, and is one of the early adopters of the new global Common Reporting Standard on exchange of tax information introduced by the Organisation for Economic Co-operation and Development. The mandatory rules introduced, known as the CRS, allow the tax authorities of implementing countries to exchange tax information and have immediate access to the tax information of any taxpayer citizen. Authorised credit institutions in Cyprus, as well as all other financial institutions, have already started, from 1 January 2016, undertaking the requisite due diligence and requesting information from account holders by way of self-certification to report to the Tax Department, which in turn will be in a position to provide any requested information to any relevant tax authority implementing the CRS. At this stage, decrees[21] are being issued by the Minister of Finance in Cyprus to clarify the exact requirements for collecting, reviewing and processing information on client onboarding, due diligence and reporting. No significant changes have been made to loan documentation, particularly considering the fact that this is a very early stage in implementation and that such matters are mostly dealt with at the due diligence stage. Any CRS provisions in loan documentation may relate to representation regarding the tax status of borrowers and caveats from lenders in connection with their obligations under CRS, if any.

v Country-by-country (CbC) reporting

Cyprus signed the Multilateral Competent Authority Agreement for the automatic exchange of country-by-country report on 1 November 2016, while the Cyprus Minister of Finance issued a relevant decree, on 30 December of 2016, which provides for a mandatory country-by-country reporting requirement for multinational enterprise groups (MNEs) generating consolidated annual turnover exceeding €750 million. The Decree is in line with the relevant Directive 2016/881/EU[22] and the recommendations of the Organisation for Economic Cooperation and Development (OECD) Base Erosion and Profit Shifting (BEPS) Action 13. More specifically, Cypriot tax-resident entities that are part of a MNE group are required to submit their CbC report, disclosing data relating, *inter alia*, to the amount

21 On 20 May 2016, pursuant to Section 6(16) of the Assessment and Collection of Taxes Law, the Minister of Finance issued an Administrative Decree relating to the application of the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information.

22 Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

of their revenue, their profit before tax and the corporate taxes paid. This information will be exchanged by the Cyprus' Tax Authorities with the relevant tax authorities of the other Member States, when required.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Under Cyprus law, lenders can take security over practically any type of asset ranging from immoveable property, such as land and buildings, to tangible moveable property, such as machinery or financial instruments, and intangible moveable property, such as receivables and intellectual property rights. The type of security varies significantly and will depend on the type of asset and the commercial objective sought. Mortgage is the most common security for immoveable properties. With respect to moveable properties, the types of security are normally liens, pledges, fixed and floating-charge debentures, assignment of receivables and other security and quasi-security instruments.

Security over immoveable property, which is the primary method of securing finances for local corporate lending, is taken by way of mortgage for the benefit of the lender and is made pursuant to the Immoveable Property (Transfer and Mortgage) Law of 1965, which requires, *inter alia*, that the instrument creating the mortgage is deposited with the Land Registry in the district where the property is located.

Upon registration there can be no further transfer or disposition of any rights in the property except with the mortgagee's prior consent. Registration fees of one-thousandth of the amount secured are payable. Similarly, a mortgage over a vessel or any share in a vessel is registered with the Department of Merchant Shipping pursuant to the Merchant Shipping (Registration of Ships, Sales and Mortgages) Law of 1963. Registration fees depend on the gross tonnage of the vessel.

Pledge of shares in Cyprus companies is customarily effected by a pledge agreement, or a 'deed of pledge', which secures the contractually binding nature of the pledge against any potential absence of consideration. The most popular method of taking security in international financing transactions is probably the pledge of shares of the Cyprus holding company that holds the underlying assets. The instrument is customarily governed by Cyprus law, but nothing prohibits the parties from making an alternative choice of law – often the law that governs the remaining finance documents, provided that mandatory provision of Cyprus law will apply in connection with the pledge. Pursuant to the Cyprus Contracts Law,[23] a pledge of shares is made against the certificates of the shares, and, for it to be valid and enforceable, it must be made in writing and must be signed by the pledgor in the presence of two witnesses, who must also sign. The law also sets certain perfection requirements for the pledge to be enforceable, namely the delivery of a notice of pledge accompanied by a certified copy of the deed of pledge to the company the shares of which are being pledged; the registration of a memorandum of pledge entered in the register of members of the company the shares of which are being pledged in respect of the pledged shares; and the issuance of a certificate by the secretary of the company the shares of which are being pledged confirming that a memorandum of pledge has been entered in the register of members of the company.[24]

23 Section 138(1)(d) of the Cyprus Contracts Law, Cap. 149, as amended.

24 Section 138(2) of the Cyprus Contracts Law, Cap. 149, as amended.

Other than the aforementioned, there is no official registry for pledged shares of Cyprus companies. Under the regime of registration of charges pursuant to Section 90 of the Cyprus Companies Law, Cap 113, a pledge of shares of a Cyprus company that constitute assets of a Cyprus holding company is exempt from registration as a charge; however, practitioners tend, as a matter of caution, to proceed to file for registration and the Cyprus Registrar of Companies will permit such filings.

Where the pledge falls within the scope of the Financial Collateral Arrangements Law of 2004, the aforementioned perfection requirements are not necessary for enforcement.

Another popular security instrument is the debenture, namely a fixed and floating charge over all assets of the borrower or other obligor. Such instruments will customarily include a fixed charge over specific and identifiable assets of the chargor and a floating charge over a very wide range of described liquid assets, the nature, volume and form of which may change from time to time by operation of the business activities of the chargor, but which will crystallise at the point of default in accordance with the terms. The floating charge will generally apply to assets such as bank accounts, receivables and royalties, but may include any other form of property or right of the chargor, present or future. These types of security instruments are generally popular with local finance institutions, which have control over the receivables, bank accounts and assets and can easily enforce such a security. The aspect of the floating charge raises certain issues in terms of enforcement and thus the appointment of a receiver is normally provided in the terms of such instruments with specific authorities and duties being prescribed. The receiver will normally be authorised to take possession of the assets covered by the security and pay off the creditor; however, there are certain statutory[25] and equitable duties that the receiver must satisfy, such as acting to obtain best price and acting fairly and in good faith, which impose great responsibility on the receiver. For this reason, prudent receivers will exercise the option under the law[26] to ask the court for directions in exercising their duties, in which case the process of enforcement is further prolonged.

Equitable assignment of rights and receivables is another form of security instrument used. This is more popular in connection with asset financing and specifically ship financing involving the assignment of earnings under ship management contracts and insurances. Such assignments can be created by way of a floating charge as indicated above or by way of a separate security instrument. In terms of perfection, the most important mechanism for both enforcement and recognition against other creditors of the security instrument is to duly notify the assignment instrument to the payee.[27]

Under Section 90 of the Cyprus Companies Law, Cap 113, a charge over a Cyprus company's property should be registered with the Cyprus Registrar of Companies within 21 calendar days of the day the charge is created. In the event that the charge is not executed in Cyprus, the time limit of registration with the Cyprus Registrar of Companies is 21 days after the date on which a copy of the instrument creating the charge could, in due course of post and if despatched with due diligence, have been received in Cyprus. In practice, this period should not extend over 42 days. The obligation to register extends to any addenda or amendments to the original instrument, but this only seems to apply to the extent that specific

25 These obligations include the duty to notify the Registrar of Companies of the appointment within seven days pursuant to Section 97 of the Cyprus Companies Law, Cap. 113, as amended.

26 Section 337 of the Cyprus Companies Law, Cap. 113, as amended.

27 *Dearly v. Hall* [1828] 3 Russ 1, notification is necessary to establish priority.

elements of the charge change. The consequence of non-registration is that any such charge will be void against the liquidator or any creditor of the company. Given that a court order will be necessary for the Registrar to accept registration if the deadline is missed, when acting for the chargee it is customary practice that the transaction document contains an obligation on the chargor to register the charge within a few business days of execution. The process of registration entails that a relevant form is filed with the Cyprus Registrar of Companies outlining the details of the charge, namely Form HE24E, which must be submitted together with a stamped copy of the instrument creating the charge. The Registrar will accept copies certified by Cyprus attorneys. After the aforementioned process is finalised, the Cyprus Registrar of Companies will then provide the company with a certificate of registration of the charge as evidence that the charge has been properly registered. In addition to the above obligation, Cyprus companies have a legal obligation to maintain an internal up-to-date register of charges and mortgages at their registered office,[28] which must, by law, be made available for inspection and can be inspected subject to certain reasonable conditions.[29]

ii Guarantees and other forms of credit support

Both personal and corporate guarantees are a standard means of establishing security under the terms of corporate lending transactions involving Cyprus parties. Personal guarantees are a more infrequent security instrument, used sometimes by local financial institutions where the borrower or its group has insufficient assets for security and, thus, a personal guarantee is sought from the ultimate beneficial owner. In the context of cross-border financing, corporate guarantees are a frequent phenomenon, often granted by the Cypriot holding company, in possession of all assets, against debt of the subsidiaries in various jurisdictions. Companies with underlying commercial benefit and if permitted under their constitutional documents, can freely provide such corporate guarantees provided no other restrictions exist by law, such as the prohibition of providing guarantees as means of financial assistance for the acquisition of own shares.[30] A guarantee under Cyprus law is a contractual right on the beneficiary and no consent, filing or registration is required. Guarantees granted pursuant to Cyprus contract law must satisfy all preconditions for a contract to be duly constituted, including, subject to certain exemptions, the requirement of the existence of consideration. Because of the nature of the guarantee and lack of direct consideration, it is customary practice to enter into such guarantees as a deed, thus defeating the requirement of consideration, and utilising pre-1960 English law principles that are adopted and applicable as part of Cyprus law.[31]

Other quasi-security mechanisms are also customarily deployed, such as negative pledge, mandatory set-off, netting and others, but these are particular to the circumstances of the financing and normally take the form of covenants under the loan documents rather than as a stand-alone security.

iii Priorities and subordination

The priority of competing interests upon liquidation of a Cyprus company is ranked as follows:

a the overall costs of liquidation;

---

28 Section 99 of the Cyprus Companies Law, Cap. 113, as amended.

29 Section 100 of the Cyprus Companies Law, Cap. 113, as amended.

30 Section 53(1) of the Cyprus Companies Law, Cap. 113, as amended.

31 Section 29(1)(c) of the Courts of Justice Law of 1960, as amended.

b the preferential debts (every local and government tax due, any unpaid wages and social security contributions due);
c the secured creditors;
d the unsecured ordinary creditors; and
e the deferred debts (such as dividends declared but not paid).

Any surplus will be distributed among the members of the company according to their rights.[32]

In relation to intercreditor issues, claims of each succeeding class rank equally among themselves and abate in equal proportions if the assets are insufficient to meet them fully. Priority between secured creditors of the same asset will be awarded to the first in time duly filing or recording the security, as applicable. Having said the above, it is possible for creditors to enter into subordination or other equivalent agreements between them, whereby they can contractually determine their priority in terms of the security interest over the same assets or debtor.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal reservations

The rights of creditors and the enforceability of transaction documents under corporate lending arrangements may be subject to the limitations arising from the laws relating to bankruptcy, insolvency, liquidation, receivership, administration and reorganisation.

Under the Cyprus Companies Law, Cap. 113, rules for protection against fraudulent preference, any conveyance, charge or mortgage relating to property made or done by or against a company within six months prior to commencement of its winding up at a time when the company was insolvent would be deemed a fraudulent preference and shall be invalid.[33] In addition, any conveyance of moveable or immoveable property, including a mortgage or charge made by any person, including legal persons, with the intent to stop or hinder payments to its creditor may be deemed void against the creditor by operation of the Fraudulent Transfer Avoidance Law, Cap. 62.

Any form of financing by Cyprus companies, whether by means of a loan guarantee, the provision of security or otherwise, deemed directly or indirectly as financial assistance for the purpose of or in connection with a purchase or subscription of shares in the company or its holding company, is prohibited under the Cyprus Companies Law, Cap 113.[34] The prohibition will apply unless the action in question is exempted; for instance, where lending is part of the ordinary business of the company, or where, in the case of a private company that is not a subsidiary of a public company, the transaction is approved by a resolution passed by holders of at least 90 per cent of all issued voting capital in the company acting in general meeting (deploying what is commonly referred to as a 'whitewash' mechanism).

Other restrictions on enforcement of security may exist in connection with relatively recent amendments of the Cyprus Companies Law, Cap.113,[35] which were prompted by

32 Section 300 of the Cyprus Companies Law, Cap. 113, as amended.
33 Section 301 of the Cyprus Companies Law, Cap. 113, as amended.
34 Section 53(1) of the Cyprus Companies Law, Cap. 113, as amended.
35 Laws No. 51(I)/2017, 33 (I)/2017, 17(I)/2017, 97(I)/2016, 90(I)/2016, 40(I)/2016, 120 (I)/2015, 89(I)/2015, 63(I)/2015 and 62(I) 2015.

efforts to revive and restructure the economy. There is now the option for a company facing insolvency to be put under the short-term protection of the court, to protect it from its creditors and to facilitate its survival. The Law provides for a maximum statutory period of six months, in which some form of compromise with creditors can be reached. The process entails that the affairs of the company are assessed by an examiner, who ascertains whether or not the company is capable of being rescued. If a rescue is possible, the examiner must bring forward a rescue plan. During the protection period, the creditors may not pursue the remedies normally available to them against such a Cypriot debtor company. Similarly, proceedings may not be initiated against any guarantor of any company debt during the protection period.

ii Opinions practice

There is no requirement under Cyprus law for any legal opinion to be issued in connection with corporate lending transactions. Legal opinions are almost never required in connection with corporate lending of local financial institutions. In the significant majority of international corporate lending transactions where any of the obligors, whether borrower, guarantor, pledgor or chargor, is a Cyprus company, especially where a foreign financial institution is involved, a legal opinion will be required by the lenders for their comfort. In practice, the lender will engage local counsel, independent of the legal counsel of the obligor, to provide a legal opinion on the Cyprus entities involved. The opinions issued customarily include confirmation of capacity and authority of the obligor to enter into the transaction documents and perform its obligations thereunder. Other matters opined upon include the enforceability of the transaction documents in accordance with their terms, especially taking into account choice of law, arbitration and other conflict-of-laws provisions.

iii Choice of law and foreign awards

The choice of law other than Cyprus law as the governing law of the transaction documents of corporate lending transactions will be recognised in the Republic of Cyprus, and that law will be applied by the courts of the Republic of Cyprus if the transaction document or any claim thereunder comes under their jurisdiction upon proof, by expert evidence, of the relevant provisions of the said law. Application of the law chosen will be restricted in relation to matters where Cyprus law mandatorily applies, such as for, instance, where a charge is created over Cyprus immoveable property.

Where the parties contractually submit themselves for the settlement of disputes to a particular jurisdiction or by way of arbitration under the transaction documents, the Cyprus courts will generally respect and enforce such provisions.

A judgment obtained in a European Member State against a Cyprus company will be recognised and enforced in the Republic of Cyprus without re-examination of the merits of the case pursuant to the rules established by Regulation (EU) No. 1215/2012[36] (which replaced Regulation (EC) No. 44/2001) and Regulation 805/2004[37] on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters and a

36 Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on the jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast). Brussels Regulation (recast) with effect from 10 January 2015.

37 Regulation (EC) No 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims.

judgment obtained in any other foreign court may be enforced in the Republic of Cyprus under common law by bringing an action on the judgment. Similarly a final arbitration award rendered against a Cyprus company in arbitration proceedings in compliance with the provisions of the transaction document in a state that has ratified the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, would be recognised and enforced in the Republic of Cyprus subject to the provisions of Law No. 84/79, which is the Cypriot law that ratified the 1958 New York Convention and made it an integral part of the law of Cyprus.

VI LOAN TRADING

Trading of loans under Cyprus law is done by way of assignment or novation in conformity with the terms of the original transaction documents. Customarily the transaction documents will provide that the lender may freely assign its rights provided notification is given to the borrower. Borrowers are generally restricted in assigning any right or transferring any obligations under the loan or any security documents without the prior written consent of the lenders. For secured loans, trading matters may be somewhat more complicated, as security instruments may also need to be assigned or novated under their original terms and other perfection requirements such as relevant filings will need to be satisfied.

As part of efforts made to address the very high percentage of non-performing loans of local financial institutions, the Cyprus government, in November 2015, passed the Law Regulating the Activities of Companies Acquiring Credit Facilities, which stipulates how and in what instances companies can acquire credit facilities from Cyprus borrowers. The Law is directed predominantly at natural-person borrowers but it can also include small businesses that have received loans from licensed credit institutions with a total loan balance (including the loans granted to the connected persons) of up to €1 million. There are certain exemptions from this Law's applicability that ensure it only applies to local financing and does not extend to international lending transactions. The scope of the Law excludes borrowers with operations or investments outside the Republic of Cyprus, borrowings whose primary security, mortgage or charge on immoveable property is located outside the Republic of Cyprus, and those transactions governed by law other than Cyprus law. Where law other than Cyprus law applies, the persons allowed to acquire credit facilities are limited and these are briefly described as only Cyprus and other EU-licensed and authorised financial credit institutions and any other person acquiring authorisation from the Central Bank of Cyprus pursuant to this law. Where a transfer of a loan is made pursuant to the aforesaid foreign law, relevant notification requirements and other restrictions apply.

VII OTHER ISSUES

i Financial collateral laws

The Cyprus Financial Collateral Arrangements Law of 2004, which transposed Directive 2002/47/EC on financial collateral arrangements into Cyprus law, alleviates perfection requirements on enforceable security and greatly facilitates the creation, validity and enforceability of financial collateral as security in terms of corporate financing transactions. For instance, in terms of pledge of shares in Cyprus companies falling within the scope of the Law, appropriation of the said shares and setting off their value is possible without having to apply for a court order. The Law applies only to specific financial collateral, as thoroughly defined therein, which can include cash, financial instruments and credit claims, as such terms are further defined. To benefit from the Law, there are a number of qualifying criteria that must be met; for example, at least one of the parties must be a public authority, a central bank, a regulated financial institution or a clearing house. Because of the uncertainty as to whether a certain security falls within the scope of the Law – such as, for example, a floating charge – the beneficiary will, in practice, always seek to perform formalities and carry out registration.

VIII OUTLOOK AND CONCLUSIONS

Pursuant to data released by the Central Bank of Cyprus, the value of non-performing loans dropped by €176.3 million in January 2017 compared with December 2016, to €23.7 billion, the lowest since the end of 2014.[38] Additionally, deposits in the Cypriot banking system increased by €332.1 million to €49.6 billion in March 2017, while loans increased by €132.8 million to €55 billion. With regard to local corporate lending transactions, there is still significant ground to cover in addressing the non-performing loans issue, despite the significant reform of the legal and regulatory framework on foreclosures and insolvency and the revised practices and regulation of the local banks including the practical implementation by banks of the reformed regulatory framework. For this reason, the banks are expected to continue to be reserved in their corporate lending activities, and will continue to focus their efforts on further restructurings. Having said that, given the continued stability and strengthening of the Cypriot economy, corporate lending has slowly but steadily been increasing and is set to increase further in future. Cyprus has an extremely well-developed framework to accommodate the use of Cyprus entities in secured international corporate lending transactions, offering, *inter alia*, legal clarity, reliability and transparency, and it is constantly improving and developing these features through the initiatives of professionals and government alike to match, if not exceed, international best practices.

38 Central Bank of Cyprus, 'Aggregate Cyprus Banking Sector Data', with reference date 31 January 2017.

Chapter 6

ENGLAND & WALES

Azadeh Nassiri and Kathrine Meloni[1]

I OVERVIEW

During 2016 and 2017 the UK loan market continued to grow, but at a steadily contracting rate. Slower growth has been attributed to the decline in demand for corporate credit as central bank measures and a low interest rate environment have continued to support a good flow of liquidity. The drop in refinancing activity (many borrowers having met their refinancing needs during 2014/15) and lessened demand for event-driven financings began in the second half of 2016 and appears attributable to geopolitical uncertainty, including the UK's EU referendum result.[2]

Lending volumes also declined across the broader Europe, the Middle East and Africa (EMEA) region. 2015 was the busiest year for lending in EMEA since the credit crisis, with loan volumes totalling US$1,162.9 billion overall. This dropped dramatically in 2016 to US$914.1 billion, as the prospect of Brexit and the election of President Trump among other factors fostered a new wave of uncertainty in the financial markets. Total loan volumes for the EMEA region in the first quarter of 2017 were US$203 billion, marginally higher than the US$195.5 billion provided in the first quarter of 2016. However, the number of deals between those quarters fell from 386 to 222, suggesting that while deals have been larger, the flow of deals has stuttered. Of that US$203 billion, 57 per cent were refinancings, down from 47 per cent of the total loan volume in 2016.[3]

The combination of a liquid market and limited demand has meant that many borrowers have been able to achieve favourable pricing and terms. It remains to be seen whether the currently borrower-friendly conditions will continue through the remainder of 2017. More recently, there have been some signs of banks adopting a more cautious approach to lending terms on a deal-by-deal basis, although this has not yet translated into a tightening across the market.

A mixture of participants remain active in the English law loan market. Traditional banks still play an important and active role in the loan market, and remain dominant in the investment-grade market. In other sectors, particularly in the leveraged, real estate and infrastructure finance markets, institutional investors (CLOs, finance and insurance companies, hedge, high-yield and distressed funds and loan mutual funds) are more prominent. The years since the financial crisis have seen the rise of alternative credit providers such as direct lending funds, particularly in the mid-market. This has been fuelled by a variety

1 Azadeh Nassiri is a partner and Kathrine Meloni is a special adviser at Slaughter and May.
2 BoE Credit Conditions Review Q1 2017.
3 LoanConnector Market Analytics.

of factors, including the pursuit of yield in a low interest rate environment, the funding gap left by constrained bank liquidity and the increasingly strict regulatory capital environment applicable to banks.

Most English-law syndicated loan transactions use the Loan Market Association (LMA) recommended forms as a starting point for negotiations. In addition to various types of facility agreement and ancillary documentation for the investment-grade market (the Investment Grade Agreements) and leveraged lending (the Leveraged Finance Documentation), the LMA collection comprises multiple templates for more specialist products, including real estate, developing markets and pre-export finance.

The LMA has done a significant amount of work on documentation over the past few years, producing a number of new templates and guidance materials and making a variety of changes to the terms of its facility agreements. The LMA's output over the past 12 months includes its response to more recent regulatory developments, for example, the announcement of further reforms to LIBOR and the implementation across the EEA of Article 55 of the EU Directive on Bank Recovery and Resolution Directive (BRRD).[4] It has also published guidance material on the implications of Brexit for the loan market. These topics and their impact on documentation are discussed in Section II, *infra*.

II LEGAL AND REGULATORY DEVELOPMENTS

Managing the steady flow of legal and regulatory changes that have emerged in response to the financial crisis, as well as other adverse events affecting the financial sector since then, remains an ongoing challenge for loan market participants.

A number of the topics outlined below have been a feature of loan documentation discussions for some time. In some cases, sufficient consensus has emerged to enable them to be addressed in the LMA templates, leaving only points of detail to be negotiated. Where there remain diverging views as to how the issue should be addressed, the contractual treatment must be agreed on a transaction-by-transaction basis.

The prospect of Brexit and its potential impact on the loan market is the development that has received the most attention from loan market participants over the past 12 months. Although the documentation implications of Brexit have been analysed in some detail, none of the legal risks identified to date have prompted changes to documentation terms that are being adopted on a market-wide basis. The nature of the key risks and the reasons why they are not being addressed in all transactions are outlined below.

i Sanctions and anti-corruption laws

Increasingly aggressive enforcement action and the severity of the penalties imposed by sanctions authorities, as well as reputational concerns, have in recent years led lenders to seek additional and specific contractual assurances from borrowers regarding the borrower group's compliance with all sanctions and anti-corruption laws to which both the borrower group and the lenders are subject.

Initially, borrowers were resistant. Historically, these topics were addressed as part of a lender's pre-contract due diligence and, in terms of contractual protection, lenders simply relied on general representations and undertakings relating to the borrower group's

4 Directive 2014/59/EU.

compliance with applicable laws. Representations and undertakings on these topics are still resisted by stronger borrowers but have become common in the English-law loan market generally over the past few years.

When such specific contractual assurances on sanctions and anti-corruption laws were first proposed, lenders' individual formulations often varied widely. The wide-ranging phrasing and uncertain limits of the representations and undertakings proposed by some lenders led to these provisions being quite heavily negotiated. The lack of consensus among lenders on the appropriate scope of contractual provisions on these topics meant that, in many transactions, diverging views within the syndicate were difficult and time-consuming to resolve.

This remains the case in some instances, but more recently, as lenders and borrowers have become familiar with the aspects that are likely to prompt discussion, many lenders are making efforts to produce initial drafts that anticipate the most common objections from the borrower side. For example, borrowers, concerned about their ability to comply with and monitor these provisions, often seek to limit their scope by reference to specific regimes (e.g., the US Office of Foreign Assets Control regime and the EU regime) rather than any sanctions regime anywhere in the world. Limitations by reference to materiality and knowledge qualifications, particularly in relation to compliance by directors, officers and other employees or the indirect use of proceeds, are also often sought. There is also evidence that lenders are tailoring their proposals more carefully to the risk profile of the borrower in question.

To date, the LMA has not incorporated any specific provisions relating to sanctions compliance into its English-law templates, although footnotes have been added to the representations and undertakings clauses to remind users to consider whether express contractual protection is required. More recently, the LMA has expanded those footnotes to highlight that if representations and undertakings on this topic are agreed, the parties should consider whether amendments to those provisions should be the subject of unanimous lender consent (rather than majority lender consent), reflecting the importance that individual lenders attach to such provisions. For similar reasons, in syndicated transactions some lenders are seeking to provide that a breach of the agreed sanctions provisions should enable individual lenders to determine whether they wish to be prepaid and have their commitments cancelled (instead of, or even in addition to, triggering an event of default that requires a majority lender decision to enforce the debt and exit the deal).

Representations relating to anti-corruption laws feature in some of the English-law LMA templates, for example the Leveraged Finance Documentation, but they are not included in the Investment Grade Agreements.

ii Benchmarks

The initial phase of reforms to LIBOR, EURIBOR and other benchmarks used in loan documentation prompted the LMA to make quite comprehensive revisions to the benchmark provisions in all of its English-law templates in November 2014. These included amendments to certain definitions to cater for changes to the administration and manner of publication (or cessation of publication) of the relevant screen rates and new fallback options, providing for the use of interpolated rates, rates for fallback interest periods and historic rates if the chosen rate is unavailable on screen. In general, these changes have been adopted without incident, although discussion is required in relation to certain optional provisions, such as the choice of screen rate fallback options.

The use of reference bank rates as a proxy for the chosen benchmark was also marked as optional because of the reluctance of banks to act as reference banks in light of the heightened compliance obligations applicable to benchmark contributors in relation to their submissions. Reference bank rates still feature in many transactions, although the institutions that are to provide these rates are normally left to be agreed as and when required, rather than being named in the agreement at the outset.

The LMA made some further, relatively minor, adjustments to its benchmark clauses over the course of 2015 and 2016. More may be necessary as LIBOR and EURIBOR move further towards the regulators' goal that any expert judgment should be removed from the calculation process as far as possible.[5]

iii Article 55 BRRD

The BRRD introduces an EEA-wide framework for the recovery and resolution of credit institutions and investment firms. Among other things, it requires Member States to confer specified resolution powers on regulators in respect of EU credit institutions, most investment firms and their groups, building on the special resolution regime put in place in the United Kingdom under the Banking Act 2009.

The United Kingdom's obligations under the BRRD prompted the addition of a new resolution tool to the Banking Act, the power to convert and bail-in the liabilities of an institution. The bail-in powers conferred on the authorities are broad-ranging. The amended Banking Act makes provision for the conversion of an institution's debt to equity and empowers the authorities to cancel or modify the terms (or the effect of the terms) of a contract under which an institution has a liability.

The ability of the Banking Act regime to interfere with a failing institution's obligations governed by foreign law (i.e., whether it would be effective to do so) has always been in question. The BRRD, as an EU measure, addresses this problem within the EEA by providing for mutual recognition. It also seeks to solve the problem, in so far as possible, in contracts governed by the laws of non-EEA jurisdictions.

Article 55 of the BRRD seeks to make the bail-in tool effective in relation to liabilities governed by the law of a non-EEA country by requiring institutions (under threat of enforcement action by their local regulator – in the United Kingdom, a fine or censure) to include in all contracts governed by non-EEA law under which they assume a liability, a bail-in clause that acknowledges that the EEA institution party is subject to those provisions. 'Liability' is not defined in the EU legislation but has been construed broadly in the UK regulatory provisions, which define 'liability' as 'any debt or liability to which the BRRD undertaking is subject, whether it is present or future, certain or contingent, ascertained or sounding only in damages'.

The main objective of the bail-in tool is to enable the recapitalisation of a failing institution; for example, by implementing a debt-for-equity swap. The LMA and others have raised concern with regard to the definition of 'liabilities' adopted by the UK regulators, as it

5 The IBA's 2016 'Roadmap' for LIBOR outlines a number of significant changes for implementation during 2017, including broadening the range of transactions that can be used as data points for submissions and a move away from the administrator's definition of LIBOR, which was used to describe the rate required of contributors historically and which is rendered obsolete as LIBOR transitions to a transaction-based rate (prompting a recent change to the LMA's definition of 'Reference Bank Rate' for LIBOR). Similar changes to EURIBOR are anticipated, although the proposals are moving at a slightly slower pace.

suggests that a bail-in clause will be required in documents containing liabilities that would seem unlikely ever to be the subject of a bail-in. For example, in the context of the syndicated loan market, BRRD firms are most often party to syndicated lending documentation as lenders or in an administrative capacity, for example, as agent. Their liabilities include their obligation to provide credit and certain contingent payment obligations, under indemnities.

To facilitate compliance with Article 55 by its members subject to the BRRD, the LMA has produced a form of bail-in clause for use in conjunction with loan documentation governed by the law of a non-EEA country pursuant to which a relevant institution assumes a liability. The LMA form of bail-in clause is currently being incorporated into most non-EEA law loan documentation, including ancillary documentation to which any lender subject to the BRRD is a party.

Following Brexit, the UK will (absent special arrangements) become a third country for the purposes of the BRRD. In anticipation, it has been suggested by some that Article 55 clauses should also be included in English law contracts (such as the investment grade agreements) under which an EEA institution has a liability and which is expected to continue beyond the UK's withdrawal from the EU.

Currently there seem to be mixed views among the banking community in the EU27 as to whether this is necessary or advisable. So far, Article 55 clauses are not being adopted in English law lending documentation on a widespread basis. The LMA has alerted its members to this issue but has not recommended that Article 55 clauses should be adopted in English law agreements.

iv IFRS 16 (lease accounting)

The new IFRS 16 was published in January 2016. It represents a major accounting change, which will have an impact on financial definitions and ratios used in loan and other finance documentation. It is mandatory for accounting periods starting on or after 1 January 2019, although it can be adopted earlier subject to conditions.

In summary, leases may be accounted for in different ways under current rules (IAS 17). In the lessee's accounts, finance leases are essentially treated as borrowings. The leased asset appears on the asset side of the balance sheet and a discounted amount in respect of the obligation to pay rent will appear as a liability, as if the lessee had bought the asset and incurred debt to pay for it. Assets leased under an operating lease, in contrast, do not appear on the balance sheet.

IFRS 16 does not substantially change the IAS 17 lessor accounting regime, but it represents a major alteration in the approach to lessee accounting. Broadly speaking, it requires all leases – including leases that are currently classified as operating leases – to be accounted for on-balance sheet.

This change has the potential to affect loan documentation in a number of ways. For example, the balance sheet recognition of operating lease commitments will affect loan terms that reference the lessee group's total assets; for example, asset-based financial ratios and guarantor coverage tests. EBITDA calculations will be affected owing to the additional charges to interest and depreciation on leases previously classified as operating leases. Particular attention has focused on provisions that purport to measure indebtedness. Loan market practice is to treat only finance lease obligations as borrowings, in line with the current accounting treatment.

The potential for uncertainty means a number of borrowers with loan facilities extending beyond the implementation date for IFRS 16 are choosing to provide expressly that any provision that incorporates the concept of a finance lease shall be interpreted as that term is interpreted on the date the facility was entered into. Underlining the importance of this development in the loan market, the LMA has recently published optional wording to this effect for use in conjunction with its recommended forms. As borrowers focus in more detail on how IFRS 16 is likely to affect their financial statements, it is anticipated that affected clauses and definitions will need to be adjusted to accommodate the implications of the new standard.

v Brexit – documentation issues

The legal and regulatory changes that will flow from the UK's departure from the EU (as well as the potential commercial implications of Brexit) have been analysed in some detail.

The key legal risks examined to date include:

a the impact of Brexit on dispute resolution options;
b the use of references to the EU and to EU legislation in lending documentation;
c the tax implications of leaving the EU for payments under loan documentation; and
d whether an Article 55 clause should be included in English law loan documentation (as noted above).

Although these topics (and others) have been analysed in some detail, in general none have prompted changes to documentation terms that are being adopted on a market-wide basis. The only exception is that in any new documentation, if a clause incorporates a reference to the EU, the parties may specify whether that term is intended to include the UK.

In relation to a number of the points initially identified, this inaction is because closer analysis has led to the conclusion that Brexit is unlikely to present an issue, at least from a UK perspective. For example, the application of the UK withholding tax regime as it affects payments under a loan agreement (discussed further in Section III, *infra*) is not predicated on EU membership.

In other cases, there is consensus as to the nature of the risk, but whether the risk needs to be addressed contractually depends on the outcome of the UK's exit negotiations. For example, there is thought to be considerable incentive for the remaining EU Member States to agree some form of reciprocal arrangement as part of the UK's exit negotiations to ensure their own judgments remain enforceable in the same circumstances as currently in the UK (as well as a number of legal options that the UK may take itself). Accordingly, in most instances the general conclusion is that unless and until the UK and the EU agree that this will not be the case, current market practice should be maintained.[6]

This is reflected in the LMA's response. Although it has published some helpful guidance material and some slot-in 'designated entity' language (see below), it has not yet recommended any changes to its template documentation. As a result, the need for and extent of any Brexit-related adjustments is likely to require attention in most loan transactions for some time to come (even if the conclusion, as in most cases currently, continues to be that no action is required).

6 The EU published a position paper on Judicial Co-operation in Civil and Commercial Matters on 29 July 2017, which states that the current EU regime on the recognition and enforcement of judgments should apply to judgments issued before the UK's exit from the EU only, but at the time of writing, this topic has not yet been addressed in the ongoing EU–UK negotiations.

vi Brexit – loss of passporting rights and 'designated entities'

The main implication of Brexit for most regulated financial institutions, in relation to loans and other products, is whether they will be able to continue to offer those products after Brexit if the EU passports on which the provisions of those products currently relies are withdrawn. Commercial lending is not a regulated activity in the UK; however, that is not the case in all EU countries so there will be transactions where a lender currently holds its commitment or participation, or both, through its UK entity and lends to borrowers in relevant EU countries in reliance on its passporting rights under the EU Capital Requirements regime. If those rights come to an end (and local regulation in the relevant country requires the lender to be locally authorised to continue to participate in the relevant facility), the lender may need to transfer its commitments to an appropriately authorised local entity or exit the deal.

Current LMA terms provide lenders with a certain amount of flexibility in this regard: transfers and assignments to affiliates do not require borrower consent, and lenders are entitled to be prepaid and their commitments cancelled if it becomes unlawful for them to continue to participate in the facility. Prompted by these concerns, in April 2017 the LMA published an additional 'slot-in' mechanic that permits lenders to designate locally authorised affiliates to participate in particular loans under a syndicated facility. This 'designated entity' language enables lenders to have appropriately authorised local affiliates ready to step in to take on particular loans, without the need (subject to applicable regulatory requirements) to pre-allocate capital in the relevant countries or undertake a full transfer process.

III TAX CONSIDERATIONS

i UK withholding tax

Payments of interest by a UK borrower or UK branch of a foreign borrower or that otherwise have a UK source and that are made on a loan that is capable of being outstanding for more than one year, are subject to UK withholding tax, currently at a rate of 20 per cent, unless an exemption applies. The UK tax regime provides for lenders to receive interest payments free of UK withholding tax if they are UK banks or UK branches of overseas banks that bring that interest into account for UK corporation tax purposes, UK tax-paying companies or partnerships, or UK building societies.

Lenders that are tax-resident outside the United Kingdom may also receive interest payments free of withholding tax if they qualify under a double tax treaty with the United Kingdom ('Treaty Lenders', in LMA terminology). As well as satisfying the conditions in the applicable treaty, directions must be obtained from Her Majesty's Revenue and Customs (HMRC) stating that the borrower can pay interest without deducting tax. The introduction in September 2010 of HMRC's Double Taxation Treaty Passport Scheme (DTTPS) has, where applicable, improved the time frames within which such directions can be obtained, but there remains a greater risk of withholding tax arising in the case of Treaty Lenders than in the case of UK lenders (unless the borrower is a strong credit and has been able to limit its gross-up obligation such that it does not apply if clearance is not obtained).

The scope of the DTTPS has recently been extended such that for loans entered into on or after 6 April 2017, the parties need no longer to be corporates. Assuming the relevant conditions are satisfied, it can now be used if the UK borrower is an individual, a partnership or a charity or if a Treaty Lender is a sovereign wealth fund, pension fund, partnership or other tax-transparent entity, provided in the last case that the beneficial owners of the interest are entitled to the same treaty benefits under the same treaty.

The treatment of UK withholding tax risk in loan documentation is well settled and reflected in the LMA's English-law templates. In summary, the borrower is obliged to gross-up the amount payable to the lenders should the borrower be required to deduct tax from such payments, provided the recipient lender was a 'qualifying lender' on the date of the agreement. The effect is to limit the circumstances in which the borrower might become obliged to deduct tax and gross-up any payment to a lender to a change in law that results in a 'day-1 qualifying lender' ceasing to be exempt from UK withholding tax.

ii Stamp and documentary taxes

No UK stamp or documentary taxes generally apply to loan, security or loan trading documentation where a security trustee structure is used (assuming the loan is not considered to have equity-like characteristics).

iii FATCA

The conclusion of intergovernmental agreements (IGAs) between the United States and a number of countries, including the United Kingdom and most of Europe, has had the effect of largely eliminating the risk of FATCA withholding for financial institutions within the scope of those agreements. As a result, lenders in jurisdictions covered by an IGA have become more comfortable with FATCA, and practice for addressing the withholding and compliance risk in loan documentation has become more settled.

In 2012 the LMA produced a series of riders for use with its facility documentation to allocate the risk of FATCA compliance and any tax deductions as agreed, which have since been updated a number of times. Rider 3, which entitles all parties to withhold as required but imposes no gross-up or indemnity obligation on the borrower, has become the standard way of dealing with FATCA risk in loan documentation in Europe, regardless of whether the borrower group includes a US entity or has US-source income. Since 2014, the Rider 3 wording has been incorporated into the Investment Grade Agreements and certain other of the LMA's templates, together with information-sharing provisions designed to facilitate compliance. The contractual treatment of FATCA risk still requires discussion in transactions involving lenders in non-IGA jurisdictions, where there remains some variation in the agreed positions.

The information-sharing provisions are deliberately worded widely enough to enable compliance with other exchange-of-information regimes, such as the OECD's Common Reporting Standards (CRS) initiative. The CRS is sometimes referred to as 'global FATCA' but, unlike FATCA, it is simply an information-exchange regime and there is no withholding obligation. The information-sharing provisions require each party to confirm its FATCA status to the other parties and supply such information as is required for the purpose of that other party's compliance with FATCA or any other law, regulation or exchange of information regime.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Types of security interest

Secured lending transactions typically involve a combination of security interests. Security can be taken over all asset classes and the choice of security interest depends on the nature of the asset and its importance in the context of the security package.

Under English law, there are four types of consensual security: pledge, contractual lien, mortgage and charge.

Pledge and contractual lien

A pledge is created through transfer of possession, where the pledgee has the power to sell the secured assets and to use the proceeds of sale to discharge the secured obligation. By contrast, under a contractual lien the lienee merely has a passive right of retention until the secured obligation has been performed

The distinction between a pledge and a contractual lien is, however, of very limited practical importance in most corporate financing transactions. The reason for this is twofold and stems from the fact that a pledge and a contractual lien are possessory security interests. First, it is not possible to create a pledge or lien over future property or land nor over intangible assets that do not fall within a very limited category of documentary intangibles (such as bearer bonds). Secondly, although many companies are willing to provide security as part of the price of obtaining finance, they will often wish to retain the ability to use and deal with the secured assets, which will not be possible where the secured creditor has possession of the assets in question.

Mortgages

Mortgages involve the transfer of title to the asset in question to the lender by way of security, with a right to the transfer back of the mortgaged property when the secured obligation has been satisfied. A mortgage is legal or equitable depending on whether legal or equitable title is transferred.[7] The form of transfer will depend on the nature of the asset in question and so, for example, mortgages over a chose in action (e.g., claims or receivables) involve the assignment of rights by way of security.

The steps required to transfer legal title to an asset and to create security by way of legal mortgage add a layer of complexity that may not be required at the outset of the transaction (see further below). In general, only freehold property, significant items of tangible moveable property, aircraft and ships are the subject of legal mortgages. In relation to other types of asset, equitable security is created and the secured creditor relies on contractual further assurance clauses and a security power of attorney to facilitate the transfer of legal title upon the security becoming enforceable.

7 An equitable mortgage arises either where the necessary requirements for a legal mortgage have not been met or where there is an agreement to create a legal mortgage. In practice, the distinction between legal and equitable mortgages, which is of relevance when determining priority rights, is reasonably straightforward to establish.

Charges

A charge involves an agreement by the chargor that certain of its property be charged as security for an obligation. It entails no transfer of title or possession to the chargee.

In practice, there is little to distinguish a charge from an equitable mortgage, as enforcement rights such as a power to take possession, to sell the secured assets and to appoint a receiver are routinely included in documents creating charges.[8] The more significant distinction is between fixed or floating charges.

Broadly speaking, a fixed charge attaches to a specific asset and restricts the chargor from dealing with (for example, disposing of) that asset. A floating charge generally attaches to a class of assets, and the chargor is permitted to deal with those assets in the ordinary course of business without the consent of the chargee pending an event that causes the charge to 'crystallise'. A typical floating charge will comprise the entirety of the borrower's assets, whether existing or future, and whether tangible or intangible.

The main consequence of the characterisation of a charge relates to the ranking of payments on insolvency. For example, expenses of both liquidations and administrations are paid out of floating charge assets. These costs and expenses can be considerable, and may well exhaust the floating charge assets. A floating charge also ranks behind certain claims of certain preferential creditors (broadly speaking certain rights of employees) and, in respect of charges created on or after 15 September 2003, the 'prescribed part', a ring-fenced fund, is also paid out of floating charge assets to unsecured creditors in priority to the floating chargee. Unlike expenses, the priority of employees and the amount of the ring-fenced fund are, generally, reasonably finite (the latter being currently capped at £600,000) and can be roughly calculated in advance by secured lenders.

The other key difference between fixed and floating charges is that the holder of a floating charge that constitutes a 'qualifying floating charge' (broadly, a floating charge relating to the whole or substantially the whole of a company's property) enjoys very privileged appointment rights in an administration. It may appoint an administrator either in court or out-of-court at any time when the charge is enforceable, and is allowed to substitute its own preferred candidate in the place of an administrator proposed to be appointed by any other person.

These consequences have acted as a strong incentive to lenders to draft charge documents, known as 'debentures', which purportedly create fixed security over as many of the chargor's assets as possible, combined with a sweeper floating charge over all of the assets of the chargor. However, it is important to bear in mind that when characterising a charge as fixed or floating, the courts will have regard to the commercial substance of the relationship between the parties. The label attached by the parties themselves will be largely irrelevant and, if it is inconsistent with the rights and obligations that the parties have in fact granted one another, the security will be re-characterised.

Common methods of taking security

The typical method of taking security over specific assets and any perfection steps[9] depend on the nature of the asset. For example:

8 There are very few situations in practice in which it would be necessary to distinguish between the two. The reason for this is that the priority position of a fixed charge is virtually identical to that of an equitable mortgage, and the registration requirements are the same.

9 Under English law, perfection steps (other than registration at Companies House) generally relate to priority and failure to take such steps does not mean a security interest will be invalid.

a Real estate: title is transferred to the mortgagee in writing alongside the title deeds if a legal mortgage is to be created. An equitable mortgagee will also generally request delivery of the title deeds.

b Registered shares: a legal mortgagee of shares must be registered as the legal owner, which may have adverse tax and accounting consequences for the lenders. Security is, therefore, often taken by way of equitable mortgage or fixed charge. To facilitate enforcement, the certificates for the shares are usually deposited with the chargee together with signed but undated forms of transfer. The articles of association are amended if necessary to ensure there are no restrictions on transfer in the event of enforcement.

c Intellectual property rights: a legal mortgage or assignment of rights to intellectual property by way of security necessitates an exclusive licence back to the assignor to enable it to continue to use the rights, including a provision for reassignment on discharge of the security. It is, therefore, more common for such rights to be the subject of a charge.

The appropriate method of taking security over claims and receivables such as book debts, bank accounts and cash varies. The key question is whether it is practical to create fixed security. If the intention is to create a fixed charge, the security document will need to contain adequate restrictions on the chargor's ability to deal with both the asset and its proceeds, and those restrictions must be complied with in practice. This generally means that the proceeds of charged receivables must be paid into a blocked account. This may be achievable in relation to certain specific sums (for example, the proceeds of a disposal that are to be used to prepay the loans). However, companies will need access to at least some of their bank accounts so fixed security will not be achievable in all cases.

Formalities and registration

Formal requirements for English-law security are minimal. For a variety of reasons, however, it is generally accepted that security documents should be executed as deeds.

Subject to limited exceptions,[10] security interests created by English companies must be registered at Companies House within 21 days of creation, whether over assets in the United Kingdom or abroad and whether or not created under an English-law security document. If this is not done, the security will be void as against a liquidator, administrator or creditor of the company and the secured liabilities will become immediately repayable.

In addition, certain types of assets (for example, real property, ships, aircraft and certain intellectual property rights) may also be registered, generally for priority purposes, on specialist registers.

Registrations at Companies House and at the land and other specialist asset registries attract nominal fees.

10 The main exemption is for interests in shares and financial instruments, cash and credit claims that constitute 'security financial collateral arrangements' under the Financial Collateral (No. 2) Regulations 2003. However, this exemption is not generally relied on in practice because of uncertainty as to how to interpret the requirement that the security asset must be within the control of the collateral-taker.

Particular challenges

There are no specific categories of asset over which security cannot be granted or over which it is too difficult to create security under English law. However:

a third-party consents may be required to create some types of security over certain leased items (including leasehold real estate) and other contractual rights and receivables, which may be challenging to obtain;

b the limits of the distinction between fixed and floating charges can be uncertain, in particular in its application to cash and receivables; and

c it is not possible to create a legal mortgage of future assets. However, it is possible to create equitable security (equitable mortgage or charge) over future assets. The terms of the security document may require the chargor to take steps to convert the equitable security into a legal mortgage upon acquisition of the relevant asset.

The grant of security is also subject to the legal limitations outlined in Section V, *infra*.

ii Guarantees and other forms of credit support

Guarantees must be documented in writing and are usually executed as deeds to prevent the guarantor from raising any questions about the existence or adequacy of consideration. Guarantees are the most common form of credit support in both secured and unsecured English-law financings.

The legal limitations outlined in Section V, *infra*, apply equally to the provision of guarantees.

iii Priorities and subordination

Priorities

The general rule under English law is that, as between competing security interests, the first in time normally prevails. However, this is subject in some cases to registration and other exceptions. The rules of priority are complex but might, very broadly, be summarised as follows:

a Where registration at a specialist registry is required, the priority of competing interests is generally determined by the order of registration.

b Registration at Companies House does not directly affect priority. Such registration may, however, constitute notice to third parties of the existence of the charge, which may affect the ranking of subsequent security.

c The priority of successive assignments of a debt or other chose in action is governed by a common law rule under which an assignee who takes an assignment without notice of an earlier assignment and is the first to give notice of assignment to the debtor obtains priority over the earlier assignee.

d A legal interest acquired for value and without notice (actual or constructive) of a prior equitable interest will normally rank ahead of the prior equitable interest.

e Special rules apply to floating charges. The grant of a subsequent fixed charge or mortgage takes priority over a floating charge, unless at the time the subsequent security is created the floating charge places restrictions on the creation of further encumbrances (in the form of a negative pledge, which is customarily included in English-law financing documents) and the subsequent holder has notice of the restriction. For this reason, a note of the negative pledge is included in the particulars of the charge that are registered at Companies House, the intention being that anyone who searches the register will thereby acquire actual notice of the restriction. Registration at Companies House may also constitute constructive notice.

Ranking and subordination

Subordination in banking transactions is typically effected by the use of structural subordination (where ranking is determined by which company in the group is a debtor (either as a borrower or guarantor) to the junior and senior creditors) and contractual subordination (where creditors contractually agree to the ranking as among themselves). Contractual subordination is generally achieved through the use of an intercreditor or subordination agreement.

Contractual subordination is often coupled with a turnover trust as a fallback to maximise the recoveries of the senior creditors in an insolvency of the debtor. Under a basic trust subordination arrangement, the junior creditor agrees that any money it receives from the debtor in insolvency (e.g., in the event of mandatory insolvency set-off or other mandatory distribution contrary to the intercreditor agreement) will be held on trust for the senior creditors to the extent of the senior debt. If effective, this has the advantage of giving the senior creditors a proprietary claim against the junior creditor, and means the senior creditors will not be exposed to credit risk on the junior creditor.

It is generally agreed that, as a matter of English law, contractual subordination should be enforceable as between the contracting parties.

In jurisdictions where trusts are not recognised, there is a risk that a junior creditor trustee will be treated as sole owner of the turnover property. There is also a limited risk that, in the event of an insolvency, the turnover trust provisions may be re-characterised as a security interest, which would be void for lack of registration. There is case-law support for the proposition that a turnover trust provision will not be re-characterised as a charge if it is limited to the amounts required to pay the senior creditor in full and it is, therefore, generally thought that this risk can be mitigated with careful drafting.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Limitations on validity and enforceability of guarantees and security

The key issues when considering the validity and enforceability of guarantees and security are capacity and corporate benefit, financial assistance rules and the clawback risks that may arise in insolvency. These issues, which are discussed below, are frequently of theoretical concern only and are usually able to be dealt with as a practical matter in a typical transaction.

ii Capacity and corporate benefit

To grant valid guarantees and security, the grantor must have the requisite capacity and there must be adequate corporate benefit.

The corporate benefit analysis must be done on a company-by-company basis and any benefit received by other members of the group may not be relevant unless, for example, there is an element of reliance and financial interdependence between the companies. As well as carefully minuting the perceived benefits, if there is any doubt the security provider or guarantor may seek the approval of its shareholders. For a company that is solvent at the time of granting the guarantee or security, a unanimous shareholder resolution will act to ratify a transaction that might otherwise fall outside the scope of the directors' powers, and is usually required by secured creditors as a condition precedent to funding in relation to upstream or cross-stream guarantees and security.

iii Financial assistance

The Companies Act 2006 restricts the provision of financial assistance, including security and guarantees, as follows:

a if the target is an English public company, neither the target nor any of its subsidiaries (public or private) may provide financial assistance for the purpose of the acquisition of the shares of the target or of reducing or discharging a liability incurred therefore; or

b if the target is a private holding company, no English public subsidiaries of the target may provide financial assistance for such purpose.

A number of exceptions apply but they are often not relevant in the context of secured lending. In practice, if security and guarantees are required from the target group following the acquisition, the relevant public companies in the target group will be re-registered as private companies before the financial assistance is given.

iv Clawback risks

Under English insolvency laws, the court has wide powers to set aside certain transactions.

Guarantees and security provided by an English company or any foreign company subject to English insolvency proceedings may be at risk of being challenged by the insolvency officer if given within a certain period prior to commencement of liquidation or administration, and if certain other conditions are satisfied.

In the case of a guarantee, the most likely ground for challenge is that it represents a transaction at an undervalue[11] or amounts to a preference.[12] In the case of security, the most likely grounds for challenge are that the transaction constitutes either a preference or a voidable floating charge.[13]

The vulnerability periods differ depending on the ground for challenge and are: six months for preferences (two years if the counterparty is a connected person); two years for transactions at an undervalue; and one year for a voidable floating charge claim (two years if the counterparty is a connected person).

v Preferences

For a transaction to be vulnerable as a preference, not only must it have been entered into within the specified period but the company must have been influenced by a desire to produce a preferential effect and must have been insolvent (as defined by statute) at the time of the transaction or become so as a result of entering into it.

vi Transactions at an undervalue

For a transaction to be vulnerable under Section 238 IA, it must have been a transaction at an undervalue within the meaning of Section 238(4) IA and entered into within the vulnerable

11 Section 238 Insolvency Act 1986 (IA).

12 Section 239 IA.

13 Section 245 IA.

period. Further, the company must have been insolvent (as defined by statute) at the time of the transaction or have become so as a result of entering into it. In practice, this ground for challenge is of relatively limited concern in most secured loan transactions because of the good faith defence that is available. This defence applies if it can be shown that the transaction was entered into by the company in good faith and for the purposes of carrying on its business, and at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.

vii Avoidance of certain floating charges

Under Section 245 IA, a floating charge may be set aside except to the extent of the value given to the company at the same time as or after the creation of the charge. If the parties are not connected, it is a defence if the company was solvent (within the statutory definition) when the charge was created and did not become insolvent as a result of the transaction.

Transactions, including security arrangements, may be vulnerable to challenge on other grounds, including that they offend the common law anti-deprivation principle which invalidates, as a matter of public policy, any agreement providing for assets belonging to a company to be removed from its estate on insolvency.

viii Legal opinions practice

The practice of delivering legal opinions and the content of those opinions is well established in the English-law loan market. As a condition precedent to funding, lenders require opinions on the capacity and authority of each borrower and guarantor and on the enforceability of the facility documentation, including any security documents.

The general expectation in loan transactions is that counsel to the creditors will deliver any legal opinions. This is usually the case in domestic transactions. In some circumstances, however, the borrower's counsel will be called on to provide an opinion.

Syndicated loan opinions are typically addressed to the agent and the lenders forming part of the primary syndicate. Sometimes, where primary syndication takes place after the signing date (for example, in the case of an underwritten acquisition facility), lenders who join the syndicate within a short period of the date of the agreement (e.g., three months) will be permitted to rely on the opinion.

Market practice has for some time been to permit the opinion to be disclosed to, but not relied on, by those who buy participations in the loan (or exposure to participations in the loan) on the secondary market.

No further reliance on or disclosure of the opinion is generally permitted without the opinion-giver's consent.

VI LOAN TRADING

English-law syndicated loan participations are regularly traded, most commonly by way of transfer by novation, assignment or sub-participation.

Novation is the simplest and most common method and involves an outright sale of the participation. All of the seller's rights and obligations in relation to the loan are cancelled and discharged and are assumed by the buyer.

If a facility is secured in favour of the lender directly, the security will be released on the novation of the lender's participation to a new lender. Security for syndicated facilities is, however, usually created in favour of a security trustee, who is appointed as trustee for the lenders from time to time. Use of a security trustee structure permits lenders to trade their participations without disturbing the effectiveness and priority of the security.

An assignment of rights to drawn loan participations (coupled with an assumption of equivalent obligations) is sometimes used as a hybrid method in circumstances where transfer by novation would disturb security or guarantee arrangements, for example in relation to certain foreign law governed arrangements.

The LMA's facility agreement templates contain a framework to permit trading by novation or assignment.

The LMA templates do not restrict sub-participation or other trading methods such as trust or derivatives arrangements that do not involve a change to the lender of record under the facility agreement. Some borrowers negotiate those restrictions, but in most cases such trades can be effected without borrower consent. These methods of risk transfer should not disturb any security or guarantees provided in favour of the lender of record (or a security trustee acting on its behalf).

VII OUTLOOK AND CONCLUSIONS

The legal, regulatory and market outlook was altered significantly on 24 June 2016 with the result of the United Kingdom's referendum on EU membership.

Much of the legal and regulatory regime that underpins activities in the English-law financial markets is derived from EU directives and regulations. Over the longer term, there will be legal and regulatory changes affecting lending and secured finance activities and documentation, but the extent of those changes (as was the case last year) is still unclear. The United Kingdom has supported most of the EU regulatory framework, many of its EU commitments are reflected in domestic law and many of the important aspects of EU regulation stem from G20 or other international commitments, which may limit the scope of any changes the government wishes to make in the longer term. In addition, the UK government has recently published a draft European Union (Withdrawal) Bill. This important piece of legislation is primarily intended to maintain the status quo as the UK leaves the EU. The draft Bill provides for the adoption into domestic law of all EU laws applicable on 'Brexit day', together with the mechanisms necessary to ensure that those laws continue to operate and make sense in a stand-alone context. It is possible that going forward, the UK will try to achieve equivalence with preexisting EU rules in many areas, but this is a topic that will continue to require attention as the Brexit landscape develops.

Helping businesses across the EU to reduce reliance on bank funding is a key plank of the European Commission's landmark project to create a Capital Markets Union, a project in which the United Kingdom will cease to play a part going forward, but the impact of Brexit on the availability of finance and the products on offer over the longer term is difficult to anticipate. As noted in Section I, *supra*, there are few current indications that banks' liquidity or funding positions have altered significantly, but it seems prudent to anticipate that lending criteria may tighten, and there are signs that banks are looking at the impact of Brexit on their customers when approving new loans. Treasurers may, therefore, focus again on alternative sources of finance.

Chapter 7

FRANCE

Karine Sultan, Yves Rutschmann, Mathieu Françon, Charlotte Bonsch, Aurélien Jolly and Anaïs Pinton[1]

I OVERVIEW

Corporate lending remains the most prevalent source of financing for French corporate borrowers, either through syndication or club deals. Over the past year or so, average loan pricing has progressively declined, which undoubtedly helped increase loan volumes. As an alternative source of funding, French corporates and especially medium-sized to large corporates have used private placements, thus allowing them to access institutional investors and diversify their financing sources.

For syndicated loans, the most widely used precedent remains the French law Multicurrency Term and Revolving Facilities Agreement published by the Loan Market Association.

Historically, private placements by French corporates were carried out by means of foreign instruments such as unrated US private placements or German 'Schuldscheins', both of which allowed medium or long-term tenors and flexible issue sizes. Since 2012, another form of private placement has emerged on the French market: euro private placements, which are medium or long-term financings granted either in the form of a loan agreement or an issue of listed or unlisted bonds between a company and a small number of investors. In 2014, a model loan agreement and a model subscription agreement (for the issuance of bonds), each drafted in French and English, were published by the Banque de France and the French Treasury for use in the context of Euro Private Placements. In January 2016, the AMAFI[2] published a Code of Best Practice for Euro PP Arrangers. Although expected to increase, the volume of trades in 2014 and 2015 has remained stable, and the total volume was, in 2016, around €2.5 billion in September (against €4.3 billion in 2015 at the same period).

Notable recent deals in France include:

a the recent syndicated loan agreement for a total amount of €8.962 billion for Semyrhamis, the holding of Groupe Familial Arnault;

b the recent syndicated loan agreement for a total amount of €6 billion for Orange;

c the recent syndicated loan agreement for a total amount of €1.3 billion for Korian;

d the recent syndicated loan agreement for a total amount of €650 million for Avril;

e the issue of bonds by Lagardère for €500 million.

1 Karine Sultan and Yves Rutschmann are partners, Mathieu Françon and Aurélien Jolly are counsels and Charlotte Bonsch, and Anaïs Pinton are associates at Bredin Prat.

2 Association française des marchés financiers.

II LEGAL AND REGULATORY DEVELOPMENTS

This section contains a high-level summary of the main recent legal and regulatory developments.

i Reserved banking activities

Pursuant to Article L. 511-5 of the French Monetary and Financial Code (MFC), the ability to carry out credit transactions on a regular basis is, in principle, subject to the monopoly of licensed credit institutions (banks) and finance companies (together with licensed credit institutions, authorised entities)). Finance companies were created in 2013 in France, and may only carry out credit transactions and, subject to exceptions, do not benefit from the European passport. In 2017, 184 finance companies were registered in France.

These restrictions are known as the 'banking monopoly'. This monopoly also extends to receiving funds from the public and providing banking payment services.

Subject to certain conditions defined by European law, an entity authorised to carry out banking activities (such as carrying out credit transactions) in a European Economic Area (EEA) Member State is entitled, if it chooses, to carry out the same permitted activities in any other EEA Member State by either exercising the right of establishment (through a branch or agents) or providing cross-border services.

Thus, a licence would be required for an entity to carry out what qualifies as credit transactions in France on a regular basis.

Breach of banking monopoly rules constitutes a criminal offence (with penalties of up to three years' imprisonment and a fine of up to €375,000).

A credit transaction is defined by Article L. 313-1 of the MFC as any act whereby a person, acting in exchange for payment (fees, interests or any other kind of payment), provides or promises to provide (1) funds to another person or (2) an undertaking on behalf of another person.

The term 'credit transaction' is therefore broad in scope and covers many types of transactions.

Exceptions to the banking monopoly

The banking monopoly regime is subject to a number of exceptions set out in the MFC and the French Commercial Code, including the issuance or subscription of bonds, deferred payment terms, vendor loans, intra-group loans (i.e., credit transactions between entities under common control) and loans granted to a company by direct shareholders owning at least 5 per cent of the share capital of the company.

Certain specific entities that are not authorised entities may, in certain circumstances, carry out credit transactions, such as insurance companies, payment services providers, crowdfunding platforms or certain funds.

The Macron law, which was released in August 2015, introduced a new exception to the banking monopoly. Under the new law, limited liability companies can extend loans with a maturity of less than two years to small and medium-sized enterprises with which they have business relationships. A decree released on 24 April 2016 sets out the various business relationships under which enterprises are authorised to extend loans and the maximum annual amount of such loans per borrower and in aggregate, depending on the size and the net cash and cash equivalent of the lending company.

ii Authorised entities and prudential obligations

Banking licences have been granted to credit institutions by the European Central Bank (ECB) since 4 November 2014. However, a filing must be made with the French banking regulator (ACPR), which assesses all applications and forwards draft decisions to the ECB. Moreover, licences for finance companies are still granted by the ACPR.

Credit institutions considered as 'important' in accordance with Council Regulation (EU) No. 1024/2013 are supervised directly by the ECB, while less important credit institutions and finance companies are directly supervised by the ACPR.

To be licensed as a credit institution or a finance company, an institution must meet certain prudential requirements relating to its share capital and its maintenance of solvency and liquidity ratios. Additional requirements pertaining to the governance and the internal organisation of the credit institution or finance company must be met (e.g., appointment of control officers, of a compliance officer or of a risk management officer).

iii Impact of Basel III, CRR and CRD IV,[3] the sanctions and anti-corruption laws

The impact of the implementation of global regulatory regulations such as Basel III, CRR and CRD IV is difficult to assess with respect to corporate lending, even if such measures certainly affect the pricing of loans made by banks.

However, as far as documentation is concerned, these regulations impact the 'increased-costs' provisions pursuant to which the costs of compliance with the regulations are to be borne by the borrower. These increased-costs clauses are usually heavily negotiated by French corporates.

In addition, the increasing range of sanctions and of anti-corruption laws implemented around the world (in particular sanctions imposed by the Office of Foreign Assets Control of the US Department of the Treasury, and since this year the French anti-bribery agency), as well as their significant extraterritorial effect and their consequences in the event of breach (as illustrated by the fine imposed on BNP Paribas in 2014), has led many lenders to seek specific representations and undertakings from the borrower in relation to these matters. These are not only required in most loan documentation negotiated recently, but also by arrangers and initial purchasers in the context of French law bond issues through representations or due diligence questionnaires.

III TAX CONSIDERATIONS

i Deductibility of interest for borrower

General rule

Interest expenses incurred by a company subject to French corporate income tax are generally deductible for tax purposes, subject to the specific limitations or anti-abuse rules described hereinafter, provided that the following criteria are simultaneously met:

- *a* the debt has been incurred for the direct purpose of the business carried out by the borrowing company;
- *b* the debt is duly recorded in its balance sheet for accounting purposes;
- *c* the financial terms and conditions of the debt are set at 'arm's length'; and

3 The Capital Requirements Regulation and Directive.

d the debt service (i.e., repayment of principal and payment of interest charges) does not exceed the financial capabilities of the borrowing company nor deprive it of the necessary funds to meet any reasonable foreseeable investment needs.

Specific limitation rules

Interest expenses deductibility is subject to the following specific limitation rules.

Definition of a 'related party'

All references to 'related parties' below mean two companies where either:

a one company controls (directly or indirectly) the other; or

b they are controlled directly or indirectly by another company.

A company is considered as controlling another company if either:

a it holds the majority of the share capital of that company; or

b it *de facto* manages that company.

French rules limiting the deductibility of interest expenses paid to shareholders or related parties (including thin capitalisation rules) are:

a Interest paid by a French company to its shareholders who do not qualify as related entities is only deductible within the limit of the average annual interest rate for certain loans granted by banks (2.025 per cent for fiscal year 2016 coinciding with the calendar year), provided that the borrower's share capital is fully paid up.

b Interest paid by a French company on loans granted by related entities is only deductible within the limit of the interest rate defined above, or, if higher, the rate that independent financial institutions would have applied under similar circumstances.

c The 'anti-hybrid limitation' provides that interest paid by a French company to related entities is only deductible if the borrower can demonstrate that, for the same fiscal year, the lender is subject to income tax on this interest for an amount at least equal to 25 per cent of the French corporate income tax as determined under standard rules.

e Interest on loans granted by related parties that is deductible under the above-mentioned limitations will only be fully deductible if it does not exceed the following limits:

- the amount of the interest multiplied by one and a half times the company's net equity and divided by the average amount of related parties' indebtedness over the relevant fiscal year;
- 25 per cent of the company's adjusted earnings before tax and exceptional items; and
- the amount of interest received from related parties.

If all the above three limits are exceeded, the portion of interest exceeding the higher of these limits cannot be deducted from the relevant fiscal year's results (unless the portion of interest is lower than €150,000). However, it can be carried forward subject to certain conditions.

Thin capitalisation rules also apply to loans granted by non-related parties, but guaranteed by related parties, subject to specific exceptions.

f A general clawback of 25 per cent of all net financial charges borne by French companies, which applies irrespective of thin capitalisation situations when the net financial charges exceed €3 million (threshold assessed at the level of the tax-consolidated group, if any).

g Anti-abuse rules may apply in specific acquisition scenarios where:

- a French target is acquired and subsequently included in the tax-consolidated group to which the acquirer belongs, if the seller: (1) directly or indirectly controls the head of the tax-consolidated group, or (2) is controlled directly or indirectly by the persons who directly or indirectly control the head of the tax-consolidated group; and
- a French company acquiring a target company cannot demonstrate that it effectively controls the target.

These limitation rules shall apply within the order specified by the law and the French tax authorities in their guidelines, it being specified that particular rules apply within French tax consolidated groups. Furthermore, specific anti-abuse rules may apply in cross-border contexts. Interest paid by French companies to entities located in low-tax jurisdictions is only deductible if the borrower proves that the interest corresponds to real transactions and is not excessive. For interest due to entities located in a non-cooperative state or territory (NCST) (that is, states or territories that do not apply international standards with respect to exchanges of tax information and have not concluded with France and at least 12 other states or territories a convention on administrative assistance allowing the exchange of information necessary for the application of their respective tax laws), the borrower must further demonstrate that the main purpose and effect of the transaction are not to transfer income to the NCST.

On 12 July 2016, the Council adopted the Anti Tax Avoidance Directive (ATAD) (Directive (EU) 2016/1164) laying down rules against tax avoidance practices including an interest limitation rule set out in Article 4. Member States shall, by 31 December 2018, adopt and publish the laws, regulations and administrative provisions necessary to comply with this Directive and shall apply those provisions from 1 January 2019. By way of derogation from Article 4, Member States that have national targeted rules for preventing BEPS risks at 8 August 2016, which are equally effective to the interest limitation rule set out in this Directive, may apply these targeted rules until 1 January 2024 at the latest. It will be interesting to see how France will interpret its interest limitation rules in respect of that derogation and whether or not France will consider that the domestic targeted rules may apply until 1 January 2024. In addition, it is unclear how the interest limitation rule provided by Article 4 will impact the above-mentioned rules (thin capitalisation rules, rules regarding specific acquisition scenarios, etc.).

ii Withholding taxes on payments to lender

Interest paid by French companies to non-residents is not usually subject to any withholding tax, except for interest paid outside France in an NCST, which is subject to a 75 per cent withholding tax, unless the company proves that the main purpose and effect of the transaction are not to transfer income to the NCST.

iii Documentary and transfer taxes

France does not levy any documentary or transfer taxes on loan agreements.

iv Impact of the Foreign Account Tax Compliance Act (FATCA)

FATCA was enacted by the United States in 2010 to combat offshore tax evasion by US persons. On 14 November 2013, the French Minister of Economy and Finance and the US

Ambassador to France signed a bilateral intergovernmental agreement intended to implement FATCA. FATCA legislation was implemented in France by Law No. 2014-1098 dated 29 September 2014.

v OECD Common Reporting Standard

The Savings Directive (Directive 2003/48/CE, amended by Directive 2014/48/EU), which provided for the automatic exchange of information between tax authorities of Member States on income from private savings, was repealed on 10 November 2015. The repeal of this Directive aimed to prevent overlap with Council Directive 2011/16/EU, which is directly inspired by the OECD Common Reporting Standard. In December 2014, Directive 2011/16/EU was amended by Directive 2014/107/EU, which entered into force on 1 January 2016, and which extends the scope of exchange of information between Member States to include, notably, interest and dividends.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Security interests over an asset must be granted in accordance with the specific set of rules applying to the category to which the asset belongs. Security packages are therefore most often documented through several separate security documents (although some law firms have recently started covering several unregistered security interests in one single security agreement).

Below is an overview of certain types of security interest that may be granted over assets located in France.

It should be noted that:

a registration always requires the payment of fees (the amount of which represents a percentage of the secured obligations for mortgages and security trusts while registration fees for other registered securities are nominal) and a renewal of the registration from time to time to maintain the effectiveness and ranking of the security interests; and

b all registered security interests must (1) be drafted in French to allow registration with the relevant authorities for validity or perfection purposes, and (2) cover the relevant mandatory points required by law to be valid.

Security interests over real estate

Mortgages

Mortgages are granted over lands and buildings. To be valid, they must be executed before a public notary. To be perfected, they must be registered with the land registry, which will trigger the payment of various costs including the real estate registration tax.

Security trusts

Security trusts require rights and assets (whether present or future) to be transferred to a trustee acting in favour of the secured creditor. The assets held by the trustee of the security trust are segregated from its own assets. They are generally used in restructuring transactions when the assets of the borrower consist of real estate.

To be valid, security trusts must be registered with the local tax authorities within one month of their execution.

Security interests over tangible moveable property

Pledges over a business

Pledges over a business are granted over the business and cover at least the trade name, the leasehold rights where the business is operated and the goodwill of the business. If expressly provided and identified in the pledge agreement, the scope of the pledge may extend to fixed assets such as furniture, machinery, equipment and IP rights attached to the business. The secured creditors may also decide to pledge machinery, equipment or IP rights under the specific regimes described below.

To be valid, they must be registered with the tax authorities and then with the registrar of the commercial court within 30 days of execution.

Registration requirements are described below, for situations where the IP rights are included within the scope of the pledges over a business.

Pledges over inventory

Pledges over inventory may be created in accordance with the French Civil Code (civil law pledges) or with the French Commercial Code (commercial law pledges).

To perfect a civil law pledge, the pledgor must effectively transfer possession and control of the pledged assets. The transfer is usually carried out in the hands of a third-party service provider, which then undertakes certain obligations.

Since an order dated 29 January 2016, with respect to contracts entered into after 1 April 2016, the regime has been simplified. However, the availability of a commercial law pledge is still limited as the beneficiary of the pledge can only be the credit institution (see Section II, *supra*) that has extended the financing secured by the security interest.

To be enforceable against third parties, the pledge must contain mandatory provisions and be registered with the registrar of the relevant commercial court.

Recent case law had decided that the use of civil law pledges was only possible in instances where the conditions for creating commercial law pledges were not met. However, the above-mentioned order dated 29 January 2016 has expressly provided that the parties can freely decide from 1 April 2016 whether to use a civil law pledge or a commercial law pledge.

Pledges over machinery and equipment

Pledges over machinery and equipment can only be granted to the seller or the credit institution financing the payment of the purchase price for the identified machinery and equipment, over which the pledge is created to secure the payment. They must be directly granted in the sale agreement or the financing agreement.

To be valid, it must be granted within two months of delivery of the relevant machinery and equipment and be registered with the tax authorities, and then with the registrar of the commercial courts within 15 days of execution.

Security interests over shares and financial instruments ('securities' under French law)

Pledges over securities account

Pledges over securities account are governed by the MFC and are only relevant where the securities to be pledged are issued by a French limited liability company that is not a limited liability partnership. They apply to the securities account on which the securities and future securities held in the name of the pledgor are registered. The securities account is opened either in a paper format register held by the issuer of the securities, or in an electronic format register by a regulated intermediary authorised by law to hold such accounts (the pledged securities account holder).

These pledges are created by the execution of a statement of pledge drafted in French, containing mandatory provisions and covering both (1) the securities account where the securities held in the name of the pledgor are registered, and (2) the special proceeds account opened in the name of the pledgor in the books of a bank or of the pledged securities account holder, where all dividends pertaining to the securities are transferred.

In practice, the security interest is registered in the securities transfer register and in the security holders' accounts of the French company.

Pledges over partnership interests

Pledges over partnership interests are governed by the French Civil Code and are applicable only to shares issued by limited and unlimited liability partnerships (which are not limited liability companies). As such partnerships are 'closed companies', granting such pledges requires the secured creditors to be approved by the shareholders as potential future shareholders.

To be perfected, they must be registered with the registrar of the commercial court.

Security interests over contractual rights, receivables and intangibles

Pledges over receivables

Pledges over receivables (including pledges over bank account) are governed by the French Civil Code and must properly identify the pledged receivables and the relevant debtor or debtors.

With respect to a pledge over a bank account, the pledged receivables will correspond to the amount of credit in the bank account at the time the pledge over the bank account is enforced, after taking into account debits and credits previously initiated but not yet completed.

As between the parties and towards third parties, the pledge is perfected as soon as it is executed, whereas a notification is required to perfect the pledge towards the debtor of the receivables.

'Dailly law' assignments

'Dailly law' assignments are security interests where a company makes an outright transfer of any claims it may have over identifiable receivables arising out of its professional activity. They are only available when the beneficiary of the assignment is a credit institution (see Section II, *supra*) that has extended the financing secured by the security interest.

To be valid, a Dailly deed must be drafted in French and contain mandatory provisions, and must be perfected on the date specified by the secured creditor in the Dailly deed.

The debtor of the receivables must be notified if the secured party wants to receive all payments pertaining to the receivables.

Cash collateral

Cash collateral is created by transferring cash to the credit of a bank account belonging to the secured creditor.

Pledges over IP rights

Pledges may be granted over all kinds of IP rights such as patents, trademarks or designs. To be perfected, they must be registered with the French Trademark and Patent Office and published in the Official Bulletin of Industrial Property.

ii Guarantees and other forms of credit support

Guarantees are commonly used in France and granted by the parent company as well as significant subsidiaries of the group (see Section V, *infra*: restrictions for corporate benefit rules), whereas other forms of credit support are limited.

With respect to guarantees, since 2006, guarantees have been governed by one chapter of the French Civil Code and may take three forms: joint and several guarantees, autonomous guarantees and letters of intent.

iii Priorities and subordination

As in other jurisdictions, financial indebtedness can be subordinated in two ways: through structural subordination and contractual subordination.

Structural subordination, where senior debt is made directly available to operational companies whereas mezzanine and junior debt is only made available to the acquisition vehicle, cannot be effected in respect of corporate lending for a single borrower and, therefore, is usually only seen in acquisition finance contexts.

Contractual subordination through subordination agreements is commonly used, and the effectiveness of such agreements has recently been recognised by Article L. 626-30-2 of the French Commercial Code in the context of safeguard proceedings. However, the effectiveness of contractual intercreditor arrangements is not free from doubt since there are no published decisions of any French courts on their validity or enforceability.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal reservations

Corporate benefit and misuse of corporate assets

The relevant entity must consider its corporate benefit and review its articles of association before guarantees or security interests are granted. Pursuant to an order dated 10 February 2016, which came into force on 1 October 2016, the contracts that are concluded by a company and that do not fall within its corporate purpose are voidable since it would constitute a lack of capacity under new Article 1147 of the French Civil Code, therefore, casting a doubt on case law applicable before such reform. Some authors and practitioners consider that the change introduced under new Article 1147 of the French Civil Code is not applicable to limited liability companies (SARL and *sociétés par actions*), but there is no certainty that courts would follow their approach. With respect to corporate benefit, this concept is not clearly defined by French law, and French courts will assess, after the event, whether the decisions taken by the directors of the company were in fact prejudicial to the company.

Failure to act in a company's corporate interest puts the relevant directors at risk of becoming:

a liable for damages on the basis of their alleged mismanagement; and

b criminally liable on the basis of misuse of a company's assets or credit. For individuals, the penalties are five years' imprisonment and a fine of up to €375,000.

As boundaries of the concept of 'group-wide corporate benefit' remain rather vague under French law, current market practice has designed (in relation to upstream or cross-stream guarantees) guarantee limitation clauses ensuring that a French guarantor's liability under its guarantee is limited to the financing proceeds directly or indirectly lent on to the French guarantor.

Financial assistance

Under French law, it is prohibited for French limited liability companies that are not limited liability partnerships that are being acquired and for their subsidiaries, including foreign subsidiaries (e.g., if the foreign subsidiary has French assets over which security is to be created), to give any guarantees or grant security interests over their assets to secure the amounts used to acquire them.

Financial assistance issues must also be considered when merging the acquisition vehicle and the target or when implementing debt pushdowns (in particular where the target group draws further new facilities, the proceeds of which are to be used as a dividend allowing the acquisition vehicle to repay the initial acquisition indebtedness).

Breaching Article L. 225-216 of the French Commercial Code is a criminal offence that exposes the directors of the company to a fine of up to €150,000. Moreover, French commentators consider that transactions not complying with Article L. 225-216 could be voided by French courts.

Insolvency, security interests and suspect period

The onset of court-driven proceedings (i.e., liquidation proceedings, reorganisation proceedings and several types of safeguard proceedings) triggers a general stay of certain claims (predating the proceedings) including:

a a stay of claims for payment having arisen prior to the judgment opening the relevant proceedings; and

b a stay of all enforcement action in respect of security interests.

French insolvency law provides for a 'suspect period', extending backward in time from the date of the judgment opening recovery or liquidation proceedings to the time when a company becomes unable to settle its liabilities as and when they fall due with its available assets. This time may be backdated to the date falling 18 months prior to the opening judgment.

Certain transactions entered into during the suspect period are automatically void. In particular, French law provides for the automatic nullification of the granting of pledges and mortgages that have been constituted during the suspect period to secure pre-existing indebtedness.

Some other transactions are voidable at the court's discretion, particularly if the court determines that the creditor knew of the debtor's suspension of payments at the time of the relevant transaction (including repayment of debts that are due and payable and transfers of assets for consideration).

ii Legal opinion practice

Characteristics of French legal opinions

There is sufficient consensus on issues relating to French legal practice for French legal opinions to be relatively standardised.

Capacity legal opinions (covering due incorporation, due corporate action and due authority of the relevant signatories) are usually delivered by counsel to the borrower whereas French law validity legal opinions (covering validity and enforceability of French-law governed documentation) are usually delivered by the legal adviser of the lenders or the bonds' initial purchasers. There are exceptions to these principles in the context of the issuance of high-yield bonds or where US parties are involved, in which case French practice is increasingly that legal advisers of the issuer and the bonds' subscribers both provide validity opinions as to the security package on the transaction.

Addressees of legal opinions usually include the security agent or trustee (where applicable), the arrangers, the initial purchasers (for bond transactions) or the facility agent and the initial lenders (for loan transactions). The provision of copies of legal opinions (without reliance) is usually permitted in respect of the affiliates, auditors and advisers of the addressees, as well as courts, regulatory authorities and potential assignees or transferees.

French legal opinions usually contain standard qualifications relating to the use of a security agent, lower-ranking security interests, the effectiveness of 'parallel debt' structures and as to the effectiveness of any pledges of future receivables that are not identifiable or properly identified.

iii Choice of foreign governing law

In accordance with Regulation (EC) No. 593/2008 dated 17 June 2008, the choice of foreign law to govern a financing is a valid choice of law that would be upheld under French law unless such a choice is tainted with fraud or if it conflicts with French international public policy or French mandatory provisions, and provided that the relevant provisions of foreign law are produced in evidence before the French courts.

iv Recognition of foreign judgments

Decisions by European courts against a debtor are normally enforceable before French courts in accordance with Council Regulation (EC) No. 44/2001, dated 22 December 2000.

For non-European countries and in the absence of a bilateral agreement between France and the country where the judicial decision has been rendered, recognition is subject to the conditions required for *exequatur*:[4] the foreign court must have jurisdiction over the case in accordance with French rules of private international law; the decision must not contravene French international public policy rules, must not be tainted with fraud and must not conflict with any proceedings or decisions having the same subject matter as a French judgment.

VI LOAN TRADING

Transfers of existing loan participations between existing and new lenders are mostly effected through assignments of receivables or through sub-participations. Before 1 October 2016, an assignment of receivables had to be formally notified by bailiff to the borrower. Following an order dated 10 February 2016, which came into force on 1 October 2016, this requirement no longer applies and a simple notification is sufficient. The assignment must be in writing, or it will be declared void. The securities provided by the assignor will remain enforceable.

4 '*Exequatur*' is a concept specific to private international law and refers to a decision by a court authorising the enforcement in that country of a judgment, arbitral reward or court settlement given abroad.

The 2016 order mentioned above has introduced, in particular, provisions relating to assignments of debts and assignments of contracts. Assignments of debts will be possible with the approval of the creditor, which can be given in advance. The creditor must also give express consent to free the initial debtor; in the absence of consent and unless otherwise provided, the debtor will still be considered as a joint debtor until full repayment of the debt by the assignee. If the creditor does not free the initial debtor, the securities will remain enforceable. Otherwise, third parties that granted securities must give their consent to maintain the securities, the guarantors will still be liable under their guarantees and the guarantee will be reduced by the amount of the assigned debt. Assignment of contracts follows the same logic as assignment of debts except that the assignment of contracts must be in writing, or it will be declared void.

Novation is rarely used, as the validity and priority over security interests would be affected.

i Loan trading and banking monopoly

The purchase of unmatured debt (i.e., the transfer from a lender of its participation in a facility) constitutes a credit transaction to which the above-mentioned banking monopoly rules apply, and as such can only be carried out by authorised entities (see Section III, *supra*) if it is deemed to be carried out in France.

The mere holding of a participation or a sub-participation in a loan to a French borrower is generally not considered by practitioners as a credit transaction to the extent that the loan has already been made available to the borrower and that no further drawing will be required from the lenders (i.e., term loans and non-revolving loans).

ii Loan trading and transfer of security interests

The assignment of receivables entails the automatic transfer of all accessory features relating to the receivables (including the benefit of personal guarantees and security interests securing the receivables). Notable exceptions include Dailly law assignments as they may only be provided for the benefit of credit institutions and cash collateral accounts that are the property of the bank to which they were initially granted, although they are subject to a restitution claim for the same amount.

The customary practice under French law documentation had been to grant security for the benefit of all finance parties directly as opposed to a security agent alone since French practitioners did not rely on Article 2328-1 in the French Civil Code, which was introduced in 2007 purportedly to allow French security agents to manage security interests on behalf of the other creditors owing to uncertainties and incompleteness of its regime. Note, however, that an order of 4 May 2017, entering into force on 1 October 2017, has been published to replace, improve and clarify the former legal regime under Articles 2488-6 et seq. of the French Civil Code. This new regime provides in particular that the security agent: (1) is now a beneficiary of the *in rem* or personal guarantees that are segregated from its own assets; (2) can be appointed in any written agreement; and (3) can take certain legal actions in bankruptcy proceedings without a special power granted by the finance parties.

In the context of cross-border transactions with main documents not governed by French law, parallel debt structures can still be used. Such concept has received only partial recognition by French case law, as it was held (in the very specific context of safeguard proceedings opened in France) that such structures governed by foreign laws were not incompatible with French international public policy rules. It remains to be seen whether such structures will be upheld by the French courts in more general contexts.

VII OUTLOOK AND CONCLUSIONS

i Significant legal and regulatory developments

As mentioned above, an order of 4 May 2017, entering into force on 1 October 2017, on the security agent has been published. As this is a new legislation that has not entered into force, practitioners have not yet used this mechanism, and there is no real insight on its implementation.

A reform in order to simplify the issue of bonds by companies has also been enacted by an order dated 10 May 2017, aiming to modernise French law in order to simplify the development of bonds issues governed by French law. Some amendments have simplified the applicable regime, in particular by clarifying the obligations of the issuers, and some amendments were made to simplify the regime when the bonds issuances are subscribed by qualified investors.

One has witnessed over the past few years an incremental erosion of the banking monopoly regime.

ii Outlook for the lending market

It is likely that the general disintermediation of the French corporate lending market will continue for the time being, along with a further diversification of available funding sources (and further inroads into the banking monopoly regime), to reflect the emergence of new market players and the development of partnerships between traditional banks and investment funds. The recent competitiveness of corporate lending by credit institutions was driven by a friendly interest rate environment.

Chapter 8

GERMANY

Christian Schmies, Nikolaus Vieten and Jens Wenzel[1]

I OVERVIEW

In 2016, the German corporate lending market continued to remain active. While there have been considerably fewer unscheduled amend-and-extend and corporate refinancing transactions owing to the fact that most of these had already been consummated in 2014 and 2015, besides scheduled refinancings, there has been a considerable number of event-driven transactions fuelled by the continuously active M&A markets.

The availability of debt capital across the various debt products generally continues to remain high and, as a result, German borrowers continue to benefit significantly from very borrower-friendly commercial and contractual conditions. Funding continues to be available for deals of any size and purpose, including multibillion-euro acquisition financings for large German corporates.

In addition to the syndicated loan market, the Schuldschein market (an established German version of a private placement with a long-standing history) has continued to be quite active in 2016 and the first months of 2017 with attractive commercial conditions for investment-grade borrowers, particularly where they seek longer-term term debt (five to 10 years). In 2016, the Schuldschein market reached an all-time high in terms of overall volumes. Also, in 2016, three Schuldschein loans have been issued and placed with individual volumes exceeding €1 billion. In addition, Schuldschein loans also become increasingly available for non-investment grade borrowers.

Unitranche financings have finally established a firm niche-position in the German market for smaller, sponsor-driven deals. While the number of deals remains limited, it is gradually increasing. The small number of unitranche financings has traditionally been attributed to the rather unfavourable regulatory framework, which generally prohibits lending by non-licensed credit institutions (with few exceptions). As the unitranche financings are usually provided by debt funds that do not hold bank licences, alternative structures had to be implemented to give the parties sufficient regulatory comfort. The regulatory impediment may, in fact, have discouraged borrowers from using unitranches more often. While it was expected that this type of financing would be further facilitated by recent changes in German legislation and the German regulator's (BaFin) administrative practice in relation to the lending, which may now be conducted by certain alternative investment funds as well as by banks (see Section II, *infra*); this expectation has, in fact, not materialised.

1 Christian Schmies, Nikolaus Vieten and Jens Wenzel are partners at Hengeler Mueller, Partnerschaft von Rechtsanwälten mbB.

In the syndicated lending market in Germany, the prevailing documentation standard is the Loan Market Association (LMA) standard. In fact, a dedicated German law-governed multi-currency facilities agreement LMA precedent for investment-grade borrowers exists. There is also a dedicated German law-governed real estate finance facility agreement for multi-property investment transactions.

In contrast, the Schuldschein market does not use harmonised documentation but in-house templates by the arranging banks, which at first glance may differ from arranger to arranger, but in substance are largely similar. The recent pan-European private placement documentation that was developed upon an initiative by the LMA, also with a view to replacing existing (national) documentations, continues to be largely avoided by the German market, and it seems rather unlikely that it will be established in the near future in Germany as an alternative to in-house documentation. On the contrary, the market continues to see an increasing number of foreign issuers tap the German Schuldschein market on the basis of the in-house form Schuldschein loan documentation.

II LEGAL AND REGULATORY DEVELOPMENTS

As indicated in Section I, *supra*, unlike many other jurisdictions, lending in Germany is generally a regulated activity that requires a banking licence under the German Banking Act if performed commercially or in a manner requiring a commercial business organisation. The licensing requirement applies irrespective of whether loans are granted to consumers or to non-consumers. According to the administrative practice of the German Federal Financial Services Supervisory Authority, the licensing requirement also applies to lenders domiciled abroad if they actively approach borrowers domiciled in Germany to grant loans. Not only the granting of a new loan but also the mere restructuring of a loan that has been acquired from the original lender (e.g., by extending maturity, adjusting interest rates) may qualify as lending activity requiring a banking licence.

The German Banking Act provides for certain exemptions from the requirement of a banking licence for lending business, in particular for insurance companies granting loans as part of their activities permitted under German insurance regulation. Furthermore, portfolio management activities by German and EU/EEA UCITS management companies and alternative investment fund managers (AIFMs) are not subject to the licensing requirement under the German Banking Act. While UCITS are generally not allowed to invest in loans from an investment regulatory perspective, EU/EEA AIFMs may, depending on the laws of their home state, be allowed to originate loans for alternative investment funds (AIFs) they manage. As the origination of such loans for AIFs managed by an AIFM is part of the AIFM's portfolio management activities, an EU/EEA AIFM can extend such loans to borrowers domiciled in Germany without being exposed to licensing requirements under the German Banking Act. For fund managers and funds domiciled outside the EEA, the impact of the recent changes is more limited. They only benefit from the exemption from the banking regulatory licensing requirement for lending business if the relevant fund may be marketed in Germany after successful completion of a notification procedure. The relevant statutory provisions in this respect make clear that a mere notification for marketing to professional or semi-professional investors, which is comparatively easy in comparison to a notification for marketing to retail investors, is not sufficient. In practice, this implies that the vast majority of non-EEA loan funds will still not be in a position to actively offer the extension or restructuring of loans to borrowers domiciled in Germany.

German funds remain subject to investment regulatory restrictions on lending. Except for special provisions applicable to shareholder loans, loans can generally only be originated by closed-ended German 'special funds' (i.e., funds restricted to professional investors or semi-professional investors, an investor category autonomously created by the German legislator). Loans to consumers are not permitted. A single loan may not account for more than 20 per cent of the fund's assets, and a German loan fund itself may only incur limited leverage (i.e., borrowing by the fund must not exceed 30 per cent of the fund's aggregate or committed capital). Fund managers managing loan funds are subject to additional organisational requirements on loan processing, which essentially replicate corresponding requirements applicable under German banking regulation to credit institutions.

While the Basel III framework has largely been incorporated into German law by virtue of the German implementation of the Capital Requirements Directive (CRD) IV directive and by the CRD IV regulation, which is directly applicable in Germany, banks still argue in credit agreement negotiations that they continue to be unable to factor the Basel III/CRD IV cost effects into their internal margin calculations. They, therefore, require borrowers to accept explicit carve-ins for the coverage of increased costs triggered by Basel III/CRD IV, even though the increased costs regime generally denies the coverage by the borrower if the legal framework already existed when the credit agreement was executed.

Huge penalties imposed on US and European banks in the United States for non-compliance with US sanctions and anti-corruption regimes have prompted many banks to put a lot more focus on ensuring compliance of their clients with these rules. In particular US banks, but also other affected banks, are now requiring extensive representations and undertakings in credit agreements in that regard from their borrowers and related subsidiaries, including the requirement to comply with US Treasury Department's Office of Foreign Asset Control (OFAC) regulations, regardless of whether the relevant borrowers and their affiliates are in fact active in the US market. This extraterritorial reach of the US regimes, in particular of the sanctions regime, creates legal issues under domestic German law. German foreign trade law contains an anti-boycott rule that prohibits German individuals and corporations from participating in a boycott if this boycott is not a sanction applied by Germany, the EU or the UN. While for most US sanctions there are similar sanctions in Germany, the EU or the UN, Cuba, for example, is not sanctioned by these bodies. Were a German national to undertake to comply with US sanctions on Cuba (included in the OFAC regulations), it would be in breach of the German anti-boycott statute. The breach would constitute an offence. This issue was typically not only raised by the borrowers but also by certain German banks if they formed part of the syndicate, as there was fear that the offence committed by the borrower could also have an impact on the German lenders. While this German 'specialty' (which in fact has a European equivalent with the Blocking Statute – Council Regulation (EC) No. 2271/96 – which prohibits compliance by European persons with certain US legislation (including the sanctions against Cuba, Iran and Libya) as this may be prejudicial to EU interests) has been a topic for discussions for some years now, the market (including the foreign banks) has recognised that the matter needs to be addressed properly. In recent credit agreements, the relevant representations and undertakings are usually qualified such that they do not apply if the relevant member of the borrower's group was otherwise in breach of applicable law. In addition, on the lenders' side, syndicate members can opt out from being addressees of the relevant representations and undertakings to ensure that they themselves do not breach applicable law when requiring the borrower to give these representations and undertakings.

The latest trend in relation to these more specific 'compliance with laws' representations and undertakings that banks require from their clients is compliance with anti-money laundering (and also anti-corruption) provisions. The focus has shifted a little bit towards this topic as several banks have been and continue to be investigated for alleged breaches of anti-money laundering laws.

III TAX CONSIDERATIONS

For German tax-resident lenders, interest payments received under a loan are subject to corporate income tax including solidarity surcharge thereon at an aggregate rate of 15.825 per cent plus trade tax (a tax levied by the different municipalities, which ranges from 7 per cent to approximately 18 per cent). Although Germany imposes a withholding tax of 26.375 per cent on certain categories of capital investment income, interest on ordinary loans is generally not subject to this withholding tax. Exceptions apply to hybrid loans (e.g., loans containing a profit participating component).

Lenders not tax-resident in Germany are, in the absence of German withholding tax, generally not subject to German taxes on interest payments made by German borrowers. There is, however, one important exception: if the loan is secured (directly or indirectly) by German-situs real estate, the foreign lender is required to file a tax return (i.e., not a withholding tax case) and pay taxes on the interest payments. Most double tax treaties concluded with Germany, however, deny Germany the right to impose taxes on such interest payments.

Typically, a customary German law loan document based on the LMA standard will contain standard LMA language (gross-up with qualifying lender concept; tax indemnity provisions). When the loan is secured by German-situs real estate, however, this language needs to be carefully rephrased to take care of the possible tax liability of a lender with respect to such interest payments.

From a German tax perspective, interest payments are generally tax deductible (subject, however, to general interest deductibility limitations such as interest barrier rules). As a consequence of the Base Erosion and Profit Shifting discussion at OECD-level, Germany is currently contemplating restrictions on the deductibility of interest payments on hybrid instruments where the lender's jurisdiction treats the 'interest' payment as a tax-exempt dividend whereas Germany treats the same payment as a tax-deductible 'interest coupon'.

Germany currently does not levy any stamp and documentary taxes on loan and security documentation or loan trading documentation (either upon execution or upon enforcement).

As regards the Foreign Account Tax Compliance Act (FATCA), Germany has concluded an intergovernmental agreement (IGA) with the United States that closely follows the Model 1 IGA. Consequently, foreign financial institutions in Germany do not need to enter into a FATCA agreement with the IRS, but rather have certain reporting requirements *vis-à-vis* the German tax authorities. For all practical purposes, FATCA should not affect regular corporate borrowers. Nevertheless, it has become market practice to include the LMA language on FATCA withholding into the standardised LMA loan agreements, whereby Rider 3 (FATCA is a lender risk) is typically used.

IV CREDIT SUPPORT AND SUBORDINATION

German law provides for several types of security interests. The main distinction is between accessory and non-accessory security interests.

Accessory security interests, such as pledges over receivables or shares, and mortgages over real estate, can only exist in conjunction with the secured claim or claims. In other words, they automatically lapse as soon as the secured claim is finally discharged or even exchanged. In addition, accessory security interests can be created for the benefit of the creditor of the secured claim only. Therefore, an accessory security interest cannot be transferred without simultaneously assigning the secured claim. This creates certain legal challenges for trading secured loans (see Section VI, *infra*).

By contrast, the existence and validity of non-accessory security interests is legally independent from the existence of any secured claims. The link between the security interest and the secured claims is created by means of a security purpose agreement. For non-accessory security interests, agency structures do not pose any particular problems, and the secured claims can easily be exchanged. Generally, non-accessory security interests, such as assignments of receivables, security transfers of title to moveables or land charges are preferred over accessory security interests.

If more than one security interest has been created with respect to the same collateral, the earlier security interest would be senior in rank to the later security interest as a matter of law as far as pledges and land charges are concerned, or the later encumbrance would not be valid if the grantor no longer holds title to the collateral, such as in the case of a prior assignment or transfer for security purposes. The order of priorities can be amended by contractual arrangement, which is commonly done through intercreditor agreements in the case of transactions involving various groups of secured creditors.

Apart from certain procedural constraints, enforcement of security is subject to a number of limitations. In the case of upstream or cross-stream security, enforcement against the assets of the security-granting subsidiary is usually limited to protect the security grantor's registered capital (based on a balance-sheet test) and sometimes also the liquidity of the security grantor, and thereby to shield its management from potential personal liability, unless the loan proceeds have been made available to the security grantor itself ('limitation language', which will usually be addressed in German law legal opinions (see Section V, *infra*)). For the statutory rules concerning the subordination of shareholder loans, see Section VII, *infra*.

For certain security interests, the insolvency administrator may be entitled to control the enforcement process and retain a certain percentage of the enforcement proceeds for the benefit of the insolvency estate ('haircut'). German insolvency law also provides for a number of contestation rights that insolvency administrators frequently use to challenge transactions (including loan repayments or the creation of security) during certain suspect periods that can extend to up to 10 years prior to the filing for the opening of insolvency proceedings. The German courts have given a very broad interpretation to a number of these contestation rights, and contestation rights have become a significant area of concern to lenders in any dealings with borrowers who experience – or might in the foreseeable future experience – economic difficulties.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Legal opinions on German law-governed credit agreements contain various legal limitations or qualifications, some of which are similar to qualifications also made in other jurisdictions, such as limitations by applicable bankruptcy, insolvency, avoidance and other laws of general application to creditors and principles of equity and good faith. Others are more specific to Germany and German law, such as the fact that longer-term agreements (such as credit agreements) may always be terminated for good cause, even if the contract provides that the agreement cannot be terminated during its agreed-upon term. German validity opinions will also mention that, under German law, any agreement to compound interest (and provisions having a similar result) will be held invalid by German courts.

More recently, the German Federal Court of Justice has held contractual clauses void that provide for an automatic termination of the contract or a right of the other party to terminate in the event of an insolvency of (or other insolvency-specific circumstances affecting) one party ('insolvency-related termination clauses'), unless these clauses correspond to specific statutory termination rights. While this decision was rendered in connection with a long-term energy supply agreement, it is discussed and argued in legal literature whether this decision will also be applied to loan agreements and the typical 'insolvency' or 'insolvency process' events of default. While there are good arguments why it should not, this matter will typically be addressed as a limitation in German validity and enforceability opinions, which will state that it cannot be ruled out that termination or draw-stop rights under a facility agreement cannot be validly exercised solely based on such insolvency-related termination clauses.

As regards the provision of guarantees and *in rem* security, German validity opinions will mention that the provision of guarantees or security by a German limited liability company or a limited partnership with a limited liability company as general partner to secure obligations of its (direct or indirect) parent company and or any subsidiary of any of its direct or indirect parent (upstream or cross-stream guarantees and security) is subject to restrictions under German capital maintenance rules and under the doctrine of interferences jeopardising the subsidiary's existence. In addition, the legal opinion is likely to mention that it cannot be ruled out that the guarantee or collateral granted might be seen as to have been granted in violation of the liquidity protection rule set out in Section 64, paragraph 3 of the German Limited Liability Companies Act if an enforcement of the guarantee or security would result in the illiquidity of the German subsidiary. As far as the guarantee and the security to be provided is concerned, the relevant agreements will customarily provide for limitation language (as referred to in Section IV, *supra*), which aims at limiting the enforceable amount to what is permissible, in particular under the capital maintenance rules, but the legal opinion will note that specific modifications to the calculation of the balance sheet test as are customarily required by the lenders may render the upstream guarantee and security to be in breach of capital maintenance requirements.

'Financial assistance' is not generally prohibited in Germany, but as far as German stock corporations are the target of an acquisition, the stock corporation must not provide any direct or indirect support to the acquisition of its shares. This prohibition also applies to subsidiaries of stock corporations. While the law explicitly states that financial assistance is not prohibited for a stock corporation if it is a controlled company under a domination and profit and loss pooling agreement (DPLA), legal opinions will contain a qualification that this should only apply if the loss equalisation claim that is the legal consequence of a DPLA is fully valuable.

Finally, in addition to the general qualifications in relation to insolvency laws, legal opinions will contain specific qualifications regarding clawback risk if collateral is granted in situations of financial distress, in particular in restructurings.

Legal opinions in German loan transactions are usually provided by both parties' counsels, with lenders' counsel usually providing the validity and enforceability legal opinion in relation to the credit agreement, the security documents and the intercreditor agreement (if any), and with borrower's counsel providing the capacity opinions for the borrower's side (i.e., borrower, guarantors and security providers).

All opinions are usually addressed to, and may only be relied upon by, the original parties on the lenders' side, namely original lenders, agents, mandated lead arrangers and book-runners. If the transaction is to be syndicated post-closing, the opinions are usually also addressed to (and may be relied upon by) the persons becoming lenders during the primary syndication of the credit agreement provided that there is a long-stop date for the lenders becoming addressees (usually three or six months during which the primary syndication is usually completed).

While the circle of addressees who are entitled to rely on the legal opinions is limited, disclosure of the legal opinions may also be made – on a strict non-reliance basis – to:

a any affiliates and advisers of the addressees to the extent they need to know the contents;

b any competent courts, or governmental, regulatory or supervisory authorities; and

c any potential (i.e., eligible) assignee, transferee or sub-participant so that the legal opinions may be made available for the purposes of loan trading, but only on a non-reliance basis.

Generally, courts in Germany will uphold the choice of foreign law governing a credit agreement, and also enforce foreign court judgments. The recognition of the choice of law is subject to the German conflicts of law principles that would prevent foreign law chosen from being recognised. Under these conflicts of law principles, the choice of foreign law would not be upheld to the extent, for example, that the result of the application would violate fundamental principles of German law or would be in conflict with internationally applicable overriding mandatory provisions of German or foreign law within the meaning of Article 9 of Council Regulation (EC) No. 593/2008 on the law applicable to contractual obligations (Rome I); or if the relevant factual circumstances are only connected with a particular jurisdiction or jurisdictions of Member States of the European Union, German Courts would apply the mandatory provisions of that jurisdiction or the European Community law irrespective of the choice of law of any other jurisdiction.

Any choice of law clause relating to non-contractual obligations, as is typically provided for in the governing law clause of LMA loan agreements, will be recognised and applied by the courts in Germany subject to Article 14 of the Council Regulation (EC) No. 864/2007 (Rome II), and subject to German public policy.

In the European context, a court decision rendered in an EU Member State will be recognised in Germany, and a court decision rendered in another Member State and enforceable in that Member State will be enforced in Germany without any declaration of enforceability by a German court being required. Each case is subject to the provisions of Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I), and the provisions of the German Act on Civil Procedure.

A final judgment of a Swiss, Norwegian or Icelandic court for a finite sum of money will be recognised and enforced in Germany subject to the Convention dated 30 October 2007 on Jurisdiction and the Recognition and Enforcement of Judgment in Civil and Commercial Matters (the Lugano Convention), as well as the applicable provisions of the German Act on Civil Procedure.

For court decisions from other non-European states and states in which the Lugano convention on enforcement does not apply, foreign court decisions are generally enforced following an action or suit brought in accordance with the rules of the German Act on Civil Procedure for an enforcement judgment. German courts will generally order an enforcement judgment without review of the merits of the foreign judgment. However, the German court would examine whether the foreign judgment is legally effective and final, whether there is any statutory or judicial impediment to enforcement and whether there are any defences (within the meaning of German Act on Civil Procedure) that have arisen after the foreign judgment became legally effective and final. In particular, an enforcement judgment will not be rendered if:

a the courts of the state to which the foreign court belongs are not competent pursuant to German law;

b the defendant, who has not participated in the proceedings and raises this defence, has not been properly served the documents initiating the proceedings or not served in a timely manner so that it was in a position to defend itself;

c the judgment is inconsistent with a judgment rendered in Germany or with an earlier foreign judgment subject to recognition, or if the proceedings on which it is based are inconsistent with a proceeding in Germany that has become previously pending;

d the recognition of the judgment would give rise to a result that is manifestly irreconcilable with basic principles of German law; or

e if in the jurisdiction of the relevant foreign court, a German judgment would not be recognised on generally equivalent conditions (reciprocity).

VI LOAN TRADING

In Germany, participations in loans are traded as in many other jurisdictions. In most cases, and certainly where the underlying loan agreements are documented under LMA standards, the secondary trading documentation is used based on the templates prepared by the LMA. In contrast to practice in the United Kingdom, a novation is normally not used as a method of transferring the participation of German law-governed loans, particularly if the loan is secured, as a novation would invalidate any pledges (or any other accessory security instruments) created under German law. This is because accessory security instruments are cancelled by operation of law if the secured claims cease to exist (see Section IV, *supra*). In lieu of a novation, an assignment and transfer by way of an assumption of contract is used in Germany, which leads to a transfer of the contractual position as a whole, with all of its right and obligations. In practice, the same result is achieved as with a novation. Besides this, ordinary assignments and sub-participations are also used as methods of transferring loan receivables (or the underlying risk).

Secondary purchasers can obtain the benefit of the security granted to the initial lenders in different ways but typically, in the syndicated lending market, as follows.

As set out in Section IV, *supra*, the key feature of the securities under German law is the distinction between accessory security rights (dependent on the claim being secured) and non-accessory security rights (which remain in place even if the secured obligation ceases to exist). This distinction also plays an important role in the transfer of security if the loan is transferred. In addition, non-accessory security can be granted to a security agent by transferring to it the assets used as collateral. In syndicated loans, the non-accessory security will usually be held by a security agent and not transferred when a share in the loan is transferred. What is transferred is the claim against the security agent for a *pro rata* share in any proceeds from the enforcement of the non-accessory security. Accessory security, in contrast, depends on a secured claim and will transfer to an acquirer of a secured claim by operation of law once the secured claim is transferred. A pledge (and any other accessory security right) can only be created to the extent the pledgee is the creditor of the secured claim. That means that a security agent cannot receive accessory security in lieu of the lenders. The security agent can only receive a pledge that secures the obligations owed to it. Therefore, any pledge received by the security agent would not secure the claims of the (other) lenders. A particular problem arises in connection with accessory security if undrawn commitments are transferred, as the security cannot transfer to the purchaser in the wake of a secured claim. This is a particular issue for secured facilities in primary syndication as, at that time, the facilities are often still undrawn. Legal practice in the lending market has developed two 'solutions' to enable the security agent to also hold accessory security and to enable the transfer of shares in the facility agreement followed by an automatic transfer of security without a requirement for the security provider to regrant the pledge or pledges, even if the facilities are still undrawn: the parallel debt concept and the future pledgee concept. Both concepts, although widely used in German secured lending, have not yet been confirmed by German courts as valid. In fact, it is doubtful whether they do operate as designed.

The security agent will usually be the only person entitled to enforce any security (the non-accessory security that is granted to it and the accessory security that is granted to the lenders), but the enforcement of this is usually delegated to the security agent by the lenders. In the documentation, lenders typically waive their right to enforce and individually delegate the exercise of that right to the security agent. As regards guarantees, this is much simpler. The guarantees are abstract (non-accessory) and made to any person who is a lender at the time the guarantee is drawn. Therefore, there is no transfer mechanism required or provided for. This is also one of the main reasons why loan agreements are secured by guarantees and not by the statutory German instrument suretyship, which is an accessory instrument.

VII OTHER ISSUES

Another issue to be considered by lenders in connection with German loan transactions is that, where lenders hold participations in a borrower (whether directly or indirectly) and those participations exceed 10 per cent of the (liable) share capital of the borrower, the loans granted by such lenders will, in insolvency, be subject to equitable subordination. In other words, they will be treated as shareholder loans and not rank *pari passu* with the other loan debt. Security created for equitably subordinated claims is not enforceable in an insolvency of the borrower. Also, in such situations, any payments received within the year before a filing for insolvency proceedings are subject to clawback by the insolvency administrator. Therefore, lenders who, either directly or through affiliated companies, are engaged in participating in companies should carefully note the shareholder structure of any borrowers they are lending to, to see if they or their affiliates might be invested in them.

VIII OUTLOOK AND CONCLUSIONS

We consider it likely that competition within and among the different debt products will continue for some time, and borrowers will make use of this beneficial market environment until the excess liquidity turns away from debt products or dries up. The extent to which debt funds will play a more important role in Germany as a financing source remains to be seen.

Chapter 9

GREECE

George N Kerameus[1]

I OVERVIEW

Because of the restrictions imposed by Greek banking legislation[2] on market access, the Greek corporate lending market mainly comprises the Greek and foreign credit institutions lawfully operating in Greece. However, a number of statutory and market developments have contributed to the actual or potential activation of other market participants.

On the basis of the above, 2016 was expected to be a year of stability, slight economic activity increase and economic growth following the previous years of deep recession; however, the uncertainties linked to the completion of the second review under the third financial assistance programme have led to an unexpected economy contraction. At the end of December 2016, the non-performing loan (NPL) ratio reached 44.8 per cent of total loans,[3] while the deposit withdrawals and capital outflows abroad have increased despite the capital control regime.

Greek systemic banks, which are all within the competence of the European Central Bank (pursuant to the provisions of Regulation (EU) No. 1024/2013) faced, and continued to face, the following severe challenges during the past year:

a the low levels of outstanding deposits and the high rates of non-performing exposures (NPEs) (despite their slight decrease by the end of 2016) pose a constant credit risk for the Greek systemic banks, hampering the supply of credit to the real economy;

b a capital controls regime (i.e., restrictions on cash withdrawals, cross-border payments and capital movements and other bank transactions) that has been imposed since July 2015 still applies, albeit with some improvements; and

c management of NPLs remains the most crucial and challenging issue – despite the reduction of NPEs as a percentage of total exposures (NPE ratio) to 45.2 per cent by June 2017 reaching the amount of €105.1 billion[4] – the stock of NPEs remains high.

---

1 George N Kerameus is a founding partner at KPP Law Firm.

2 See Article 9(2) of Law 4261/2014 (on access to the activity of credit institutions and prudential supervision thereof (transposition of Directive 2013/36/EU)), pursuant to which the business of granting loans or other credits may only be exercised with the issuance of a prior special licence issued by the Bank of Greece (BoG). Loans or other credits between associated enterprises or granted to individuals or legal entities by enterprises for the sale or provision by the latter to the former of their goods or services are exempted from the above general prohibition.

3 Bank of Greece, Overview of the Greek Financial System, January 2017 available online at www.bankofgreece.gr/BogEkdoseis/OVERVIEW_OF_THE_GREEK_FINANCIAL_SYSTEM_Jan_2017_en.pdf.

4 Bank of Greece, Report on Operational Targets for Non-Performing Exposures, June 2017 available online at www.bankofgreece.gr/BogEkdoseis/Report_Operational_Targets_for_NPEs_EN_clean_Final_June_2017.pdf.

Against this backdrop, banks kept on refinancing outstanding loans on a stand-alone or syndicated basis, while at the same time corporate debt restructuring projects have been gradually increased during 2016. To the same end, a number of issues (such as limited debt restructuring options, a statutory auction moratorium, lengthy legal procedures, strategic defaulters, preferential claims of the state and pension funds, etc.)[5] have been at least to some extent addressed with a view to efficiently managing the NPL issue whereas significant progress has been noted by the BoG so far granting servicing licences to four NPL servicing entities.[6]

Other than the above, large Greek corporates continue to proceed with the issuance of bonds, which are traded on the Greek stock exchange (Mytilineos, OPAP and Fourlis bonds) as well as on European stock exchanges (Ireland, Luxembourg, etc.).

Finally, international financial institutions, such as the European Investment Bank (EIB) (including the European Investment Fund), the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation, have continued to be active in the Greek corporate lending market, providing either direct loans to Greek corporates or loans and guarantees to Greek banks in their capacity as financial intermediaries for the granting of liquidity and trade finance products in the Greek market.

II LEGAL AND REGULATORY DEVELOPMENTS

The major legal and regulatory developments of the market within 2016 and early 2017 have been:

a the amendments to the Bankruptcy Code introduced by Law 4446/2016, including important changes to the Greek restructuring and insolvency framework, with the aim of enhancing the preventive restructuring regime as well as all insolvency proceedings;

b the amendments to the NPL Law (Law 4354/2015) introduced by Law 4389/2016, with the aim of enhancing the transparency of the sale and service of NPLs;

c the out-of-court debt settlement introduced by Law 4469/2017, with the aim of creating an out-of-court process that will facilitate the settlement of debt with all lenders, including financial institutions, tax and social security authorities;

d the establishment of a regulatory framework for crowdfunding platforms and the liberalisation of interest rates of corporate bonds introduced by Law 4416/2016.

i Bankruptcy Code amendments

The Greek Bankruptcy Code (Law 3588/2007) (GBC) has undergone a series of reforms in recent years; the rehabilitation procedure as a preventive mechanism for the insolvency of distressed businesses was introduced by Law 4013/2011, followed by significant amendments introduced by Laws 4055/2012, 4072/2012 and 4336/2015 with the aim of expediting the insolvency proceedings, enhancing their effectiveness and encouraging the restructuring of viable businesses.

5 See Ilias Pkaskovitis, member of the BoG General Council and SSM Supervisory Board, EBRD/BoG Workshop, 'Greek banks after recapitalisation: the agenda for NPL resolution', (Athens, 10 March 2016).

6 Cepal (Aktua Hellas) (a joint venture between Alpha Bank and Spanish servicer Aktua), Financial Planning Services (a Eurobank subsidiary and Pillarstone Greece, a subsidiary of the US-based KKR fund) and Thea Artemis (an ATTICA Bank subsidiary) have received a non-performing loans management licence by the BoG, and another 10 applications have been filed with the BoG.

In December 2016, the GBC was further amended by Law 4446/2016 in an attempt to tackle some of the remaining irregularities and inefficiencies that arose through its application. One significant modification relates to the elimination of the in-court restructuring proceedings, (i.e., the initiation of restructuring negotiations with creditors after the issuance of a formal court order) owing to the ascertained abuse of the legal framework by debtors who solely intended to gain judicial protection (even temporary) with, however, no viable prospect of being efficiently restructured. At the other end, the out-of-court restructuring proceedings (pre-pack) have proven to be more efficient, since the restructuring plan has already been approved by the majority of creditors prior to its submission to the court for ratification.

Another major development that affects the market relates to the protection of the interim financing of the business that is under restructuring. According to the new Article 154 of the GBC, the necessary financial resources that are granted by lenders within a period of six months prior to the submission of the restructuring agreement to the court and up until its ratification with the aim of sustaining the operation of the business, enjoy a superseniority over all other claims, even if the restructuring agreement is for whatever reason not ratified by the court (as a motivation to lenders to participate in the financing of viable businesses).

Pursuant to the new Article 100 paragraph 1 of the GBC, possible obstructive behaviours of debtors are addressed, by enabling creditors to initiate restructuring proceedings without the consent of the debtor. In case the debtor has ceased all payments, creditors representing 60 per cent of the total claims against the debtor (which shall also include at least 40 per cent of the claims of any creditors with security *in rem* or prenotation of mortgage) may submit a restructuring agreement to the court for ratification.

An important step towards the efficiency of restructuring proceedings' implementation is further introduced by the automatic issuance of a tax and social security clearance certificate irrespective of the existence of debts under restructuring to the Greek state and the Social Security Authorities provided by Article 106c paragraph 3 of the GBC. The issuance of these certificates will allow for the effective implementation of the restructuring agreement (especially the provision of the new financing and the realisation of asset v. debt transactions).

In 2016, the extraordinary procedure of special administration regime introduced by Law 4307/2014, has been implemented for the first time (e.g., Zinon Real Estate SA, Grivalia Properties SA) allowing for the rapid sale of the defaulting party's assets through the public tender for the auction of the debtor's total assets. Within this framework, the process can be initiated solely by creditors representing minimum 40 per cent of the total claims against the debtor including at least one banking institution, and the whole process must be completed within 12 months of the application. DOL (a former news conglomerate) is the most recent and well-known special administration case that has been concluded within 2017.

ii NPL Law amendments

By virtue of the provisions of Law 4354/2015 and BoG ECA 118/19.5.2017, a secondary loan market has been established in Greece to contribute to the resolution of the NPLs issue. Further to the latest statutory amendments introduced to the applicable regime of servicing and selling loan receivables by Laws 4389/2016, 4393/2016 and 4472/2016, the following are the main features of the secondary lending market framework:

a performing and non-performing (90 days past-due rule) loan receivables (including those guaranteed by the Greek state) may either be sold or outsourced for servicing. Loans secured with a primary residence mortgage or prenotation of mortgage over a real estate with an objective value of up to €140,000 cannot be sold until 31 December 2017, but their servicing can be assigned to third-party eligible servicers. The regime of servicing and selling non-performing loans does not apply for loans granted by the Loans and Consignments Fund (i.e., a state-owned financial institution);

b the legal framework now clearly provides for three types of operations, namely servicing, acquisition and refinancing:
- servicers, which may only be societes anonyme established in Greece or Greek branches of foreign institutions established in an EEA country, shall operate as special purpose vehicles, which are licensed (the prior opinion of a committee of the Ministry of Finance as a requirement for the issuance of the licence is no longer needed) and supervised by the BoG, and must have capital of at least €100,000, which increases to €4.5 million should they wish to be involved in refinancing operations. Pursuant to the latest amendments introduced by Law 4472/2017, servicers may manage real estate acquired by the beneficiary of the loan provided that it constitutes security of the loan to be serviced. However, servicers are not entitled to acquire by any means the relative real estate;
- buyers are not required to be licensed but need to enter into a servicing agreement with a licensed servicer, otherwise the sale of NPLs transaction will be null and void; buyers may only be societe anonyme companies established in Greece, companies established in an EEA country subject to EU legislation and companies established in non-EEA countries with the exception of non-cooperative jurisdictions and preferential tax jurisdictions, as defined in the Greek Income Tax Code; and
- refinancing operations (of the loans acquired and managed) are strictly considered as banking loans and, therefore, subjected to applicable Greek regulations (e.g., subject to the levy of Law 128/1975 but exempted from stamp duties and from withholding tax applicable on interest);

c privileges and preferential treatment of banking institutions are maintained after the transfer of the receivables, irrespective of whether the buyer is such an institution; and

d originators and borrowers shall engage in a 12-month consultation period pursuant to the provisions of the Code of Conduct as a prerequisite for the sale of the receivables, whereas the buyer/servicer will continue the actions already taken prior to the sale without having to repeat these as under the previous regime.

Despite the above statutory developments that have addressed to some extent the NPL regulatory gap, there are still constraints and impediments, such as delays in the enforcement process, as well as legal inconsistencies with the Greek securitisation legislation (e.g., Law 3156/2004). Recent developments, however (see the NPL securitisation transaction of Attica Bank within its capital restructuring exercise) indicate the necessity of the market to overcome such impediments.

iii Out-of-court debt settlement

By virtue of Law 4469/2017, an out-of-court debt settlement mechanism has been established in a bid to render faster and easier the debt restructuring of both individuals and legal entities. The following are the main features of the out-of-court debt settlement framework:

a individuals eligible for bankruptcy and any Greek tax resident legal entity that earns income deriving from business activity pursuant to Articles 21 and 47 of the Income Tax Code may submit an application to fall under the scope of Law 4469/2017, provided that:
- on 31 December 2016 they have a loan or credit obligation in arrears (minimum 90 days) towards a financial institution or assessed and outstanding obligations towards the tax authorities or the social security authorities or another legal entity of public law, including local government authorities or they have an obligation that has been subject to an arrangement after 1 July 2016;
- the total amount of their obligations exceed the amount of €20,000;
- the eligibility criteria are met pursuant to Article 3 of Law 4469/2017 (i.e., in at least one fiscal year within the last three prior to the submission of the application either the EBITDA is positive, for debtors maintaining a single-entry bookkeeping system or the EBITDA or the net present position (equity) is positive in case of a double-entry bookkeeping system;
- the obligations to be settled have been generated prior to 31 December 2016;

b the appointment of an accredited mediator acting as a coordinator in a bid to facilitate the negotiations between the debtor and the creditors;

c creditors representing at least 50 per cent of all claims against the debtor must participate, in order for the proceeding to commence, whereas 60 per cent of all claims (which shall also include at least 40 per cent of the claims of any creditors with security *in rem* or prenotation of mortgage) is required for the conclusion of the agreement;

d for large enterprises the appointment of a financial advisory expert is mandatory in a bid to perform a sustainability review;

e the out-of-court debt settlement agreement may be submitted to the court for ratification either by the debtor or one of the creditors to the end of imposing its provisions to all creditors even if they do not participate as contracting parties; and

f a 70-day automatic stay on all individual and collective enforcement actions of creditors participating in the out-of-court debt settlement procedure pursuant to Article 13 of Law 4469/2017, granted after the notification of the completion of the debtor's file to the creditors pursuant to Article 7 and an automatic stay on all individual and collective enforcement actions of creditors participating in the settlement granted after the submission to the court of the agreement and until its ratification.

iv Crowdfunding and corporate bonds

By virtue of Law 4416/2016, a statutory framework has been introduced providing for the effectiveness of existing, or the establishment of alternative, financing tools. More specifically, pursuant to Article 20 of the same law, the interest rates for bond loans offered publicly and bond loans offered through a private placement to qualified investors pursuant to Article 2 paragraph 1 of Law 3401/2005 can be agreed freely, without a maximum cap.

Pursuant to Article 21 of the same Law, the following can be appointed as bondholder agents within the framework of bond loans issued under the provisions of Law 3401/2005: credit institutions, investment firms providing not only underwriting services but also safeguarding services for financial assets for its clients, as well as the central securities depositary.

By virtue of Articles 23 and 24 of the same law, specific legislation relating to crowdfunding has been introduced and its most significant provisions are the following:

a a public offer may be conducted without a previous release of a prospectus, provided that the following conditions are met:
  - the offer takes place exclusively via an electronic platform operated by: (1) investment services societes anonymes that have been granted a licence to provide at least investment services of reception and transmission of orders on behalf of clients and safeguarding services of financial assets; (2) alternative investment funds management societes anonymes licensed to provide investment services of reception and transmission of orders; and (3) credit institutions providing services of reception and transmission of orders; and
  - securities offered have a total value less than €500,000, a limit which is estimated per issuer in a time frame of 12 months;

b participations of private clients pursuant to Article 2 paragraph 8 of Law 3606/2007 may not exceed the amount of €5,000 and the threshold of 10 per cent of their average income as declared in tax declarations in the last three-year period per issuer and the amount of €30,000 per year and platform operator. The monetary thresholds set above may change pursuant to a decision of the Minister of Finance, followed by the proposal of the Hellenic Committee of Capital Markets; and

c platform operators are obliged to provide minimum information to their clients or their prospective clients relating to the issuer of the offered securities

iv Other developments

On top of the above, the provisions of Directive 2014/49/EU on national deposit guarantee schemes have been transposed into the Greek legal system, by virtue of Law 4370/2016, regulating the Hellenic Deposit and Investment Guarantee Fund as well as setting the framework for easier and faster access to the guaranteed amounts of the deposits.

Last but not least, the capital controls regime that has been in place in Greece since 28 June 2015 has loosened, allowing for further corporate transactions.

III TAX CONSIDERATIONS

i General tax considerations

Interest payable on credit facilities granted by credit institutions is not subject to withholding tax; it has been clarified that, under the provisions of the new Greek Income Tax Code, applicable as of 1 January 2014, this exemption also applies to foreign banks.

A 15 per cent withholding tax is levied on interest from bond loans issued by resident companies.[7] The same withholding tax rate, pursuant to domestic provisions, is imposed on interest paid or credited for a loan or credit provided by a lender that is not a credit institution.

The above tax treatment should not alter when interest has been paid in the form of proceeds from a guarantee claim or from enforcement of security.

In cases where, under local provisions, interest payable to foreign lenders is subject to the 15 per cent withholding tax, the lower rate among the following shall apply:

7 Under the Income Tax Code provisions, the exemption of non-resident companies without a permanent establishment in Greece from any withholding tax on interest from bond loans issued by resident companies no longer applies (it applied until 31 December 2013).

a the rate provided by treaty (if any) for the avoidance of double taxation concluded between Greece and the state of which the foreign lender is a tax resident; or
b the rate provided by the EU Interest and Royalties Directive, if the relevant statutory conditions are met.

Foreign banks or other lenders do not acquire a permanent establishment in Greece solely because of the granting of a loan to a Greek company or of obtaining a guarantee or security therefrom.

Loans granted by Greek or foreign banks to Greek companies and bond loans in general, as well as securities granted in relation to these, are exempted from Greek stamp duties. However, an annual contribution at the rate of 0.6 per cent is imposed on the average outstanding monthly balance of each loan granted by a Greek or foreign bank to a Greek resident. Loans between banks, loans to the Greek state, loans funded by the EIB, EBRD and IFC, and bond loans are exempt from this contribution.

There are, in principle, no adverse legal consequences for a borrower if some or all of the lenders are organised under the laws of a jurisdiction other than Greece. Thin capitalisation rules exist in Greece, but their application is not affected by the residence of the lenders. Deductibility of interest may be disallowed under special tax anti-avoidance provisions (or the general anti-avoidance provision included in Article 38 of the Code of Tax Procedure).

The 2016 amendments to the NPL legislation have shed some light on the tax treatment of the transactions and players of the secondary lending market. More specifically, interest payments to buyers (or servicers) of receivables are not subject to withholding tax; capital gains from the transfer of receivables is subject to corporate income tax and, therefore, on that basis capital loss should also be recognised; from an indirect tax point of view, the transfer of receivables is exempt from VAT and refinancing operations are not subject to stamp duty but to the 0.6 per cent annual contribution.

Most importantly, the debtors' benefit arising from the write-off of obligations towards credit institutions, buyers and servicers is exempt from income and donation taxes, under specific (time) conditions. It should be noted that this exemption does not extend to intra-group lending.

In addition, pursuant to the newly introduced provisions of Article 43 of Law 4465/2017, the debit and credit risk balance of credit institutions that arises from debt restructuring pursuant to applicable statutory provisions to debt transfers is deductible from their gross income in 20 equal annual instalments. Such debit balance may not exceed the amount of accumulated provisions and other credit risk losses accounted for up to 30 June 2015.

Last but not least, under the terms of the relevant framework, which was amended in 2015, Greek banks are entitled, as of 2017 and under certain circumstances, to convert to final and settled claims against the Greek state the deferred tax assets arising from their debit balances related to debt provisions, debt restructurings or for which deferred tax assets are accounted for their participation in the private sector involvement in the 2012 restructuring of Greek sovereign debt and from accumulated provisions and general losses.

Such claims are recognised without the assumption of future profitability provided by CRD IV and therefore are not deducted from CET1 regulatory capital but are assessed as a 100 per cent weighted asset with a corresponding beneficial effect on the capital position of the credit institution.

The claims are set off against income tax. If no set-off may take place, then the credit institution issues shares that are attributable to the state. Existing shareholders have a pre-emption right to acquire such shares, which become freely transferable, if not acquired by them within a reasonable period.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

The two basic categories of security rights under Greek law are:

a collateral *in personam* (mainly guarantees); and

b collateral *in rem* (mortgages or prenotation of mortgages over immoveable assets and pledges over moveable assets and rights).

Non-attachable assets or claims are not available to secure lending obligations.

Given that specific establishment, publication and registration requirements may apply depending on each type of either the security or the asset on which the security is granted, different agreements in relation to each type of asset are commonly used. The procedural steps depend on whether a court decision, notarial deed or private agreement is statutorily required for the lawful establishment of the security, as well as whether the decision, agreement or deed has to be registered with a specific authority and meet any publication requirement.

A company may grant a security interest to secure its obligations under a credit facility as a borrower, a guarantor of the obligations of other borrowers or guarantors of obligations, or even as a third party, without the need to be named as a guarantor or co-borrower.

Collateral, in the form of either a mortgage or a prenotation of mortgage, may be taken over real property (land) and plant, as well as all component parts and accessories of the immoveable (i.e., machinery and equipment), which are owned by the security provider and are fixed (or exist) thereto.

According to the provisions of the Greek Civil Code, a mortgage is the right *in rem* established in favour of a creditor over a person's full ownership (or usufruct) rights on immoveable property (land and buildings) to secure a monetary obligation by means of the creditor's preferential satisfaction.

A prenotation is a type of temporary mortgage, which may be rendered final provided that: (1) a final court decision orders payment of the due and payable claim that is secured by the prenotation; and (2) the prenotation is converted to a mortgage within a period of 90 days from the issuance of the court decision. Given their equal treatment as to enforceability and ranking, prenotation is usually preferred because of the lower costs involved.

As to the procedure, a mortgage may be established bilaterally by means of a notarial deed, or unilaterally by means of a court decision; a prenotation of mortgage is always established by virtue of a court decision (either on a bilateral or a unilateral basis). For the perfection of both types of securities, the court decision or the notarial deed must be registered with the competent land registry or cadastre.

Under both types of security, possession of the real property is not conveyed to the creditor.

Pursuant to special statutory provisions applicable to (prenotations of) mortgages securing claims of credit institutions:

a said securities are protected from clawback in the event of bankruptcy of the collateral provider;

b the securities extend to any machinery and equipment that enters the mortgaged plant even after the establishment of the security;

c the collateral provider is prohibited from removing or transferring the machinery and equipment, without the prior consent of the creditor; and

d enforcement procedures are facilitated.

Receivables (present or future) may be pledged under the provisions of the Civil Code on the basis of a written agreement, which shall take the form of a notarial deed or a private agreement bearing a certain date (the latter is preferred because of its minimal costs). The agreement is executed between the creditor and the collateral provider and must be notified to the debtors of the pledged receivables to be perfected.

Pledges of current or future business receivables may also be established under the provisions of Articles 11–15 of Law 2844/2000; in addition, collateral security over business receivables may take the form of a floating charge under the provisions of Articles 16–18 of Law 2844/2000, which is established on a group of claims or rights. Such claims or rights are freely collected or disposed of by the security provider, who is, however, obliged to substitute them with similar claims or rights. Finally, claims may be pledged in favour of credit institutions licensed in Greece pursuant to the beneficial provisions of Legislative Decree 17 July 1923.

A pledge over cash deposited in bank accounts is commonly realised in favour of credit institutions under the provisions of either Legislative Decree 17 July 1923 or Law 3301/2004 (the Collateral Law), transposing into Greek law EU Directive 2002/47/EC on financial collateral arrangements. The procedure involves in this case, too, a pledge agreement in the form of a notarial deed or a private agreement bearing a certain date, which is notified to the bank maintaining the accounts.

Shares in companies incorporated in Greece may be pledged as security of claims arising from lending transactions. The pledge is extended to dividends and other monetary or personal rights deriving from the shares, unless otherwise agreed.

A pledge of either bearer or registered shares is realised in accordance with the aforementioned procedure provided by the Civil Code, with the additional requirement of delivery of the share certificates to the pledgee, whose details shall be noted on the share certificates, as well as into the shareholders' book, in the case of registered shares. In the case of dematerialised listed shares, the pledge needs to be registered with the Dematerialised Securities System. Finally, a pledge of listed shares may also be effectuated pursuant to the provisions of the Collateral Law.

Given its purpose (i.e., to be sold), inventory (products) is commonly pledged, under the provisions of Articles 16–18 of Law 2844/2000, in the form of a floating charge over a group of assets (the inventory), which remain in the possession of the security provider, the latter being entitled to dispose, with the concurrent obligation, however, to substitute them with similar assets. A floating charge is perfected by virtue of its registration in the public registers kept with the competent pledge registry.

Finally, as to trademarks registered with the Greek Trademark Office, the relevant pledge agreement shall be registered with the Trademarks Registry.

As to costs, these vary depending on the type of security. In the case of mortgages, notarial fees range from 0.2 per cent to 1 per cent of the security value plus VAT (currently amounting to 24 per cent), and legal fees are also payable if lawyers are involved. In the case of prenotation of mortgage, court fees do not exceed €500. Registration fees for both securities amount to 0.775 per cent of the security value in the case of land registries, or 0.875 per cent in the case of cadastres. Registration of pledges or floating charges falling within the provisions of Law 2844/2000 in the public register kept by the competent pledge registry is burdened with fees equal to 0.775 per cent of the security value. The above security charges are significantly reduced for bond loans issued by Greek companies under the provisions of Law 3156/2003. Registration of the pledge of dematerialised listed shares to the Dematerialised Securities System costs €120 (per issuer and type of share). The fees of court bailiffs for the notification of a security document amount to €35–€95 per service.

Last but not least, challenges to taking effective security are set by:

a Law 1892/1990, pursuant to which consents shall be obtained as to agreements involving the acquisition, establishment of security or leases of rights *in rem* on real property within Greek border areas (as well as shares in companies with such real rights) by individuals or legal entities that are not EU or EFTA nationals; and

b Law 3310/2005, pursuant to which any agreement (including a security document) in respect of rights in shares representing at least 1 per cent of the share capital of a media company or a company taking part to a public tender is null and void, unless the agreement is executed before a notary public and notified to the Greek National Council for Radio and Television.

ii Guarantees and other forms of credit support

Article 23a of Greek Company Law provides that a company is prohibited from guaranteeing the borrowings of associated legal entities, unless the following (quite strict) conditions are cumulatively met:

a the guarantee serves the company's interests; such an issue is a factual and multidimensional one and therefore has to be examined on a case-by-case basis. If this condition is not met, then the guarantee is considered null and void and directors' liability (including penal) may arise;

b the company has a right of recourse against the principal debtor (i.e., the associated enterprise in favour of which the guarantee is provided);

c the general meeting of shareholders (GM) of the guaranteeing company approves the transaction by an increased special quorum and majority; moreover, an approval by the GM, which shareholders representing one-tenth of the paid-up share capital (one-twentieth in the case of listed companies) shall not oppose, is required. The board of directors shall submit to the GM a report confirming satisfaction of the conditions for the lawful granting of the guarantee, and the resolution of the GM shall be registered with the Companies' Registrar and meet the statutory publication requirements; in the case of companies whose financial statements are subject to consolidation, pursuant to Articles 90–109 of the Greek Company Law, the GM approval shall be resolved by a two-thirds majority (increased to 95 per cent majority, if provided on a post-transaction basis); and

d the claims of the lender in whose favour the guarantee is provided are subordinated to the claims of the company's existing creditors.

Moreover, the provision of the guarantee shall serve the guarantor company's interests.

Finally, lack of corporate power (i.e., total absence of the relevant scope in the company's articles of association) is an issue only to the extent that a guarantee is considered as not serving the attainment of the company's business scope, in which case it is null and void, pursuant to the aforementioned conditions. On this basis, lenders usually require the provision of guarantee to be included in the business scope article of borrower companies' constitutional documents.

Greek financial institutions are not subject to the above regime and may freely guarantee borrowings of members of their groups.

As to negative covenants commonly provided by debtors to creditors, they constitute only contractual obligations of the former to the latter, which may not affect the validity of the rights *in rem* acquired by third parties.

iii Priorities and subordination

The priority of secured creditors is in principle dependent upon the day of perfection of the security (i.e., its registration in the relevant public register if such a registration is statutorily required). Consequently, secured creditors of a lower class (i.e., perfected at a later date) will be (partially or wholly) satisfied, only if the secured creditors over the same asset of the previous class are fully satisfied. If registered within the same day, security rights share the same ranking and are satisfied on a *pro rata* basis.

As mentioned in Section II, *supra*, the Code of Civil Procedure provides for the order of priority that applies to the allocation of enforcement proceeds from the auction of a specific asset in the event of multiple creditors participating in the relevant proceedings with claims that are higher than the auction proceeds.

Greek laws do not include rules on subordination agreements between lenders, who are free to agree by contract the order of priority and the method of sharing proceeds among them in the event of debt acceleration. However, the aforementioned order of priority set by law will obligatorily be followed in the event, due to enforcement or bankruptcy, of a distribution of liquidation proceeds by the competent body of the auction procedure, notwithstanding subordination agreements between lenders (which may, of course, be subsequently followed).

However, the following securities offer a safe harbour from the mandatory priority and statutory subordination provisions:

a a pledge of claims under the provisions of Legislative Decree 17 July 1923 where the credit institution arguably acquires full ownership thereof and is entitled to liquidate the claim, with the obligation to refund to the borrower any amount exceeding its secured claim; and

b financial collateral arrangements under the provisions of the Collateral Law, which provide for the satisfaction of the creditor through sale, set-off or application of the financial instruments or cash in discharge of the relevant obligations.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

As to financial assistance, pursuant to Article 16a of the Greek Company Law, a company (other than a credit institution) is prohibited from providing guarantees or giving security to support borrowings incurred to finance the direct or indirect acquisition of shares in the company by any third party (other than the employees of either the company or an associated company) unless: the general meeting of shareholders provides its prior consent to the guarantee or security by an increased quorum and majority, on the basis of a board of directors, report on the reasons for, and the company's interest in, approving the transaction – as well as an auditor's report if members of the board of directors of the issuing or parent company are directly or indirectly contracting parties to the relevant transaction; and the secured amount, which shall appear in a non-distributable reserve as long as the security is outstanding, does not cause the company's own funds to fall below the aggregate amount of share capital and non-distributable reserves.

In cases of bankruptcy, the court usually imposes a temporary moratorium on individual and collective enforcement actions (i.e., prohibiting the lender from commencing or continuing enforcement procedures against the debtor who has been declared bankrupt).

In addition, a security agreement is subject to the clawback provisions of the Greek bankruptcy code[8] (security agreements are in principle protected from clawback if established by virtue of the provisions of the Collateral Law or Law 4112/1929, and if carried out in the framework of a reconciliation plan).

Finally, the Greek bankruptcy code provides that creditors with a real security on an asset of the bankruptcy estate are satisfied solely by the liquidation of the asset, with an option, however, to waive their security and be satisfied by the whole bankruptcy estate, in which case their claims are subordinated pursuant to the Greek bankruptcy code provisions. Securities under the Collateral Law are in principle not affected by the bankruptcy proceeding.

During bankruptcy proceedings, the same order of priority of payments applies as that mentioned in Section II, *supra*.

As to foreign governing laws and judgments, Greek courts recognise and enforce:

a contracts that have a foreign governing law on the basis of the provisions of the Rome Convention on the law applicable to contractual obligations and Regulation (EC) No. 593/2008, whichever is applicable, subject to: rights *in rem*, which are governed by the law applicable pursuant to the conflict of law rules; Greek public order; and overriding mandatory provisions; and

b a foreign judgment without re-examination of the case, pursuant to the applicable provisions of EU regulations, in the case of judgments from other EU Member States (e.g., Regulations (EC) No 44/2001 or No. 805/2004, or Regulation (EU) No. 1215/2012); bilateral international conventions; and the relevant provisions of the Greek Code of Civil Procedure.

However, Greek courts may deny recognition in the event that the foreign judgment is not an enforceable title or *res judicata* in the foreign country; it is issued by a foreign court not having jurisdiction under Greek law; it violates Greek public order; the defendant was deprived of the right to a fair trial; or the foreign judgment is contrary to a Greek judgment that is *res judicata* for the same issue and parties.

Besides the above, it is common practice for the following reservations to be included in legal opinions issued under Greek laws:

a waiver of rights and claims arising from gross negligence or fraudulent or wilful misconduct is null and void;

8 According to the Greek bankruptcy code, transactions (i.e., donations or other transactions with disproportionately small consideration, payments of non-outstanding debts and establishment of *in rem* securities) held during the suspect period are subject to clawback, upon request of the bankruptcy administrator or a creditor. The suspect (preference) period is determined by the bankruptcy court and may not start earlier than two years from the date of issuance of the court decision declaring bankruptcy. Furthermore, transactions carried out within a period of five years preceding the declaration of bankruptcy are conditionally subject to clawback.

b the borrower of a monetary loan has in no case the obligation to pay, because of its default as to repayment, any indemnity other than statutory or contractually agreed (default) interest; in this respect, it has been ruled that a defaulting party is not liable to default interest where the events or circumstances giving rise to the same were outside its sphere of influence (force majeure);
c applications for interim relief may be heard by the courts in the country (if competent) notwithstanding any provisions to the contrary;
d a court of the country (if competent) may, at the request of a person concerned, reduce damages or penalties to their proper measure;
e it is within the discretion of a court of the country (if competent), in cases of breach, to order specific performance or award damages;
f contracting parties are required to mitigate their losses; failure to do so may reduce or extinguish altogether the amount of losses to which they would otherwise have been entitled; and
g pursuant to Greek jurisprudence, irrespective of the fact that lending by credit institutions is not subject to statutory interest limitations applicable to non-banking lending transactions, a counterparty to a banking lending transaction is not deprived from the right to argue and prove that an interest rate in excess of the non-banking maximum interest rate is abusive.

VI LOAN TRADING

The transfer of an existing lender's rights and obligations arising from a loan agreement is allowed, unless otherwise provided by applicable contractual provisions. Such a transfer is commonly effectuated under the assignment and transfer of rights provisions of the Civil Code. To be perfected, the transfer shall be notified to the debtors (borrower and guarantor). Any security (*in rem* or *in personam*) rights are also transferred to the new lender.

Further to the above assignment route, loan receivables may be transferred:
a in the quite efficient structure of a securitisation transaction pursuant to the provisions of Law 3156/2013; or
b under the provisions of Law 4354/2015, which establishes a secondary loan market in Greece (see Section II, *supra*).

VII OUTLOOK AND CONCLUSIONS

The Greek lending market needs to get ahead of the wider economic crisis of the country, as well as of the liquidity problems faced by its major players (i.e., the Greek banks). Furthermore, the economy needs to break the barriers imposed by the capital controls regime. In addition, the market needs to resolve the NPL issue on a more consistent basis. Some legislative measures have been adopted in the areas of restructuring enforcement, bankruptcy and establishment of a secondary lending market, but their positive contribution has not yet been adequately proven. Within this framework, it seems that, in one way or another, the existing statutory limitations to market access have to be removed.

Chapter 10

HONG KONG

Peter Lake[1]

I OVERVIEW

While slower economic growth and geopolitical turbulence contributed to a second consecutive year of reduced syndicated loan volumes in the Asian loan markets, Hong Kong loan volumes hit a record US$106 billion, up by 22 per cent. from 2015.[2] Hong Kong and China were the only Asian loan markets to exceed US$100 billion in loan activity in 2016.

One of the more significant Hong Kong loan transactions of 2016 was a US$12.7 billion bridge loan for China National Chemical Corp's 43 billion franc bid for Swiss pesticides and seeds company Syngenta AG. The acquisition itself was China's largest foreign takeover to date,[3] and the bridge loan financing was voted as 2016's syndicated deal of the year by the Asia Pacific Loan Market Association in Hong Kong.[4] Another significant financing deal in 2016 was the Tencent-led consortium's US$3.5 billion acquisition financing from a group of 17 international and Chinese banks for its acquisition of Finnish mobile game developer Supercell Oy.[5] The Tencent consortium acquisition is the world's largest acquisition of a gaming company. The year also saw rare loan markets activity from MTR Corporation Limited and the Airport Authority.

Hong Kong has an active bilateral loan market.

Syndicated lending is generally documented using the facility agreement forms prepared by the Asia Pacific Loan Market Association.

The main providers of finance are the Hong Kong-regulated financial institutions that have been authorised under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) as 'authorized institutions' to hold banking licences. Funds and private equity houses are more visible in bilateral bridge or other short-term bespoke financing arrangements.

1 Peter Lake is a partner at Slaughter and May. The author would like to thank his colleague Antonia Tjong for her assistance in preparing the Hong Kong chapter.

2 'Asia Pacific loans hit three-year low despite Chinese M&A boom', published by Thomson Reuters on 30 December 2016.

3 Basis point Feature, 'Asia Pacific: Asian lending slides to three-year low', published on 4 October 2016.

4 Bloomberg: 'ChemChina's $12.7b Loan for Syngenta Wins Asia-Pacific Award', published by Bloomberg on 8 February 2017.

5 'Asia Pacific loans hit three-year low despite Chinese M&A boom', published by Thomson Reuters on 30 December 2016.

II LEGAL AND REGULATORY DEVELOPMENTS

i Companies Ordinance

On 3 March 2014, a restatement of the Companies Ordinance (Chapter 622 of the Laws of Hong Kong) was brought into effect. Of particular note to lenders are the following changes:

a A reduction of the time period to register charges with the Companies Registry. The time period was reduced from five weeks to one month. The list of registrable charges was also amended and the underlying instrument of charge is now publicly available.

b Financial assistance no longer results in underlying transactions becoming voidable (although it remains a criminal offence for the companies giving financial assistance). The exemptions from financial assistance have been broadened.

c There have been changes to the terminology for financial statements.

d The abolition of the concepts of nominal share capital and premium, and of authorised share capital.

e The retirement of the memorandum of association.

f There is an additional procedure for Hong Kong-incorporated companies to execute documents by way of deed but without affixing the common seal.

Lenders have expressed concern with respect to the clarification under the new Companies Ordinance that charges over bank accounts are not charges over book debts (and so are not registrable under that head of registration). Lenders receiving security over bank accounts wish to protect their position by ensuring the bank account charge is registered at Companies Registry. In light of the fact that bank account charges are not registrable *per se*, the usual technique to register a bank account charge is to note to Companies Registry that the bank account charge may be construed as a floating charge (as all floating charges are registrable under a separate head of registration).

With underlying instruments of charge now publicly available, the Companies Registry has stated it is now 'more important than ever' for lenders to make enquiries and search the Companies Register for charges. Although there is no Hong Kong case law on this point, the availability of the underlying instrument of charge will likely impact upon the issue of priorities between competing charge instruments.

ii FATCA

Hong Kong has implemented a Foreign Account Tax Compliance Act (FATCA) Model 2 intergovernmental agreement. Although there remains variance in terms, as far as borrower risk is concerned, the market has moved towards a balanced position.

iii Basel III – capital adequacy and capital buffer

Capital adequacy ratio

The Hong Kong Monetary Authority (HKMA) has issued rules under the Banking Ordinance (the Banking (Capital) Rules) (Chapter 155L of the Laws of Hong Kong) that prescribe in detail how the capital adequacy of locally incorporated authorised institutions should be calculated. These rules are based on the Basel III recommendations (which were implemented in Hong Kong on 1 January 2013).

A Hong Kong-incorporated authorised institution is required under the Banking (Capital) Rules to maintain a Common Equity Tier 1 (CET1) capital ratio of at least 4.5 per cent, a Tier 1 capital ratio of at least 6 per cent and a total capital ratio of 8 per cent. Branches of foreign banks are not subject to this requirement but, based on the HKMA's past practice of generally requiring any foreign bank that wishes to establish a branch in Hong Kong to maintain a capital adequacy ratio of at least 8 per cent, it is likely that the HKMA will continue to require foreign banks to meet the three minimum risk-weighted capital ratios.

Capital buffers

In accordance with the Basel III recommendations, the HKMA may require an authorised institution to have further capital buffers to cater for risks and uncertainties that are not already captured by the three minimum risk-weighted capital ratios that comprise the 'capital adequacy ratio' described above. The HKMA has implemented the following capital buffers: the capital conservation buffer, the countercyclical capital buffer and (for domestic systemically important banks) the higher loss absorbency requirement.

The capital conservation buffer is being phased in equal annual increments. The capital conservation buffer is 1.25 per cent for 2017, and will increase to 1.875 per cent in 2018 and then to its upper level, 2.5 per cent, in 2019.

The level of the countercyclical capital buffer is determined by the HKMA's analysis on whether there is excess aggregate credit growth associated with a build-up of system-wide risk in Hong Kong. On 27 January 2017, the HKMA announced that the countercyclical capital buffer will increase from the current 1.25 per cent to 1.875 per cent with effect from 1 January 2018. This is in accordance with the maximum countercyclical counter buffer permitted for 2018 under the Basel III phase-in arrangement. The HKMA regards a continued build-up of the buffer as appropriate given the risks associated with recent credit and property market conditions and external political uncertainties.

The higher loss absorbency (HLA) requirement applies only to domestic systemically important banks (D-SIBs). It is an extension of the capital conservation buffer. On 31 December 2016, the HKMA announced that Hong Kong's list of D-SIBs remains unchanged from December 2015. The five D-SIBs are: the Hongkong and Shanghai Banking Corporation Limited, Bank of China (Hong Kong) Limited, Hang Seng Bank Limited, Standard Chartered Bank (Hong Kong) Limited and the Bank of East Asia, Limited.

iv Sanctions and anti-corruption

Hong Kong banks must comply with the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Chapter 615 of the Laws of Hong Kong), which in particular sets out specific customer due diligence and record-keeping requirements that must be followed. In March 2015, the HKMA issued the guidance paper 'Anti-Money Laundering Controls over Tax Evasion'. The guidance paper is in addition to the HKMA's 'Guideline on Anti-Money Laundering and Counter-Terrorist Financing', which itself was modified slightly in March 2015. Both the guidance paper and the Guideline assist authorised institutions in complying with the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance.

Hong Kong-authorised institutions are required to check and report against the list of names issued under the US President's Executive Order 13224 and the list of names published under Hong Kong's United Nations (Anti-Terrorism Measures) Ordinance (Chapter 575 of the Laws of Hong Kong) (which is updated to reflect changes to the list of specified terrorists and terrorist associations designated by the United Nations Security Council).

Hong Kong has a separate enforcement agency, the Independent Commission Against Corruption (ICAC), to counter corruption. Its main focus is on preventing bribery (in both the public and private sectors).

v Benchmarks

Hong Kong Interbank Offered Rates (HIBOR) are available for borrowings in Hong Kong dollars and yuan (although the majority of offshore yuan-denominated loans do not use the HIBOR rates in respect of interest calculations). The HKMA issued a statutory guideline 'Code of Conduct for Benchmark Submitters', which came into effect on 3 May 2013. The guideline forms part of the HKMA's Supervisory Policy Manual.

vi Banking resolution

EU Bank Recovery and Resolution Directive

With the implementation of Article 55 of the EU Bank Recovery and Resolution Directive (2014/59/EU), EU-based lenders typically require loan facilities that are governed by Hong Kong law to include contractual recognition of bail-in – whereby non-EU entities acknowledge that the EU lender may be subject to bail-in powers under that EU directive. The relevant language is usually based on the bail-in template language prepared by the Loan Market Association.

Hong Kong Financial Institutions (Resolution) Ordinance

Hong Kong's Financial Institutions (Resolution) Ordinance (Chapter 628 of the Laws of Hong Kong) commenced on 7 July 2017. The legislation is designed to meet international standards set by the Financial Stability Board. In due course, it is likely that contractual recognition of bail-in for non-Hong Kong law contracts will be required. The market language will no doubt closely follow the Loan Market Association's bail-in template language.

vii Insolvency regime

Hong Kong's insolvency regime remains creditor-friendly with no specific debtor resolution regime in place.

Amendments to the Companies (Winding Up and Miscellaneous Provisions) Ordinance 2016 (Chapter 32 of the Laws of Hong Kong) came into force on 13 February 2017. The amendments seek to enhance creditor protection, streamline the winding-up process and strengthen regulation under the winding-up regime.

The amendments introduce new provisions to empower the court, upon the application of the liquidator, to set aside 'transactions at an undervalue'[6] entered into within five years before commencement of the winding-up. The amendments also clarify existing provisions relating to transactions that are 'unfair preferences' entered into within six months (or, for a person connected to the company, two years) before the winding-up. For both provisions,

6 The meaning of 'transaction at an undervalue' is defined in the new Section 265E. A company enters into a transaction with a person at an undervalue if (a) the 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 (b) 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.

in order for them to apply, the court must be satisfied that the company is unable to pay its debts at the time such transaction is made, or the company becomes unable to pay its debt as a consequence of such transaction.

When setting aside such transactions, the court may make an order as it thinks fit to restore the position to what it would have been had the company not entered into these transactions.

III TAX CONSIDERATIONS

The Hong Kong tax regime includes three separate types of income tax – property tax, salaries tax and profits tax. Of the three income taxes, profits tax is most relevant to lenders.

Hong Kong does not have a separate capital gains tax regime.

i Profits tax

Hong Kong adopts a territorial source principle of taxation.

Under the Inland Revenue Ordinance (IRO) (Chapter 112 of the Laws of Hong Kong), profits tax is charged on a person carrying on a trade, profession or business in Hong Kong; and in respect of income profits (excluding capital gains profits) arising in or derived from Hong Kong from that trade, profession or business.

The rate of profits tax for corporations is 16.5 per cent for the year of assessment commencing 1 April 2017.

Carrying on a trade, profession or business in Hong Kong

A low threshold is required to fall within the scope of carrying on a trade, profession or business in Hong Kong. The activity of depositing may, for example, be sufficient to constitute a business.

Income arising in or derived from Hong Kong

If the above test – of carrying on a trade, profession or business in Hong Kong – is satisfied, then profits tax will (subject to exemptions) be chargeable if the income arises in or is derived from Hong Kong.

This is a factual issue, which is determined by looking at what the taxpayer has done to earn the relevant profit. A test often applied in difficult cases is where the operations take place from which the profits in substance arise. The place where a taxpayer's profits arise is not necessarily the place where he or she carries on business.

Inland Revenue Department guidelines and case law assist in determining the locality where income arises, or where it is derived from.

Because of the difficulties in assessing the locality of interest and related fee income received by financial institutions, the Inland Revenue Department issued Departmental Interpretation and Practice Notes No. 21: Locality of Profits (revised July 2012), setting out the Inland Revenue Department's current practice. A modified extract from the practice note on the tax treatment of interest from loans is set out below.

Types of interest income from loans	Tax treatment
Offshore loans initiated, negotiated, approved and documented by an associated party outside Hong Kong and funded outside Hong Kong (i.e., funds raised and loaned direct to the borrower by a non-resident; for example, head office, branch, or subsidiary, etc.) albeit through or in the name of the Hong Kong institution.	100 per cent non-taxable
Offshore loans initiated, etc. by the Hong Kong institution and funded by it in or from Hong Kong.	100 per cent taxable
Offshore loans initiated, among others, by an associated party outside Hong Kong but funded by the Hong Kong institution.	50 per cent taxable
Offshore loans initiated, etc. by a Hong Kong institution but funded by offshore associates. It is considered that this category only applies to start-up positions where the Hong Kong institution has yet to establish a market presence.	50 per cent taxable

Note on 'funding'.
For claims concerning loans funded by offshore associates, two essential requirements will have to be satisfied, namely:

a *that the Hong Kong institution does not have the authority to seek its own source of funds in respect of the loans; and*

b *there must be documentary evidence to show that funds have been directly provided by an offshore associate even though such funds may have been routed through another vehicle in Hong Kong. In other words, arbitrary funding by another group vehicle in Hong Kong will not satisfy this requirement.*

Note on 'initiation'.
'Initiation' refers to the efforts exerted in obtaining the particular business including solicitation, negotiation and structuring of the loans. The financial institution must be able to substantiate that the mandate or invitation to participate was secured as a direct result of the activities of an associated party outside Hong Kong for an offshore claim to succeed.

Participation, commitment and other fees will follow the tax treatment accorded to the related loan under the above.

Deductibility of interest paid by borrowers

Payments of interest by a Hong Kong corporate that are incurred in the production of its chargeable profits are generally deductible, subject to certain anti-avoidance provisions. The anti-avoidance provisions seek to deal with the lack of symmetry in tax treatment on interest received (as the starting point is that interest income is not taxable while interest expenses are tax-deductible).

ii Double taxation agreements

As of 17 July 2017, Hong Kong had comprehensive double taxation agreements with Austria, Belgium, Brunei, Canada, the Czech Republic, France, Guernsey, Hungary, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Liechtenstein, Luxembourg, Malaysia, Malta, Mexico, the Netherlands, New Zealand, the People's Republic of China, Portugal, Qatar, Romania, Russia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.

Comprehensive double taxation agreements that have been signed but are not yet in effect have been made with Belarus, Latvia and Pakistan.

The terms set out in double taxation agreements take precedence over the other provisions of the IRO.

iii Stamp duty

Hong Kong stamp duty is chargeable on certain transactions (including the issue of certain bearer instruments) but is not chargeable on the entering into or transfer of loan facility agreements (on the basis that a transfer under a loan facility typically will not require registration in a register located in Hong Kong).

Lenders may therefore transfer their commitments and loans either by way of assignment or novation.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Common methods of taking security in Hong Kong include:

a Mortgage:
- Mortgages involve the mortgagor transferring the property to the mortgagee, with the mortgagor having an equitable right to have the property returned upon paying off the debts to which the mortgage relates. Although it may be used for a variety of types of property, it is more commonly used for real property. The Conveyancing and Property Ordinance (Chapter 219 of the Laws of Hong Kong) sets up a statutory overlay in respect of Hong Kong real property, so that any mortgage of a legal estate in Hong Kong real property may only be effected at law by a deed expressed to be a legal charge (which type of charge is a creature of statute).

b Charge or assignment by way of security:
- Hong Kong recognises both fixed and floating charges, with fixed charges taking priority over floating charges where the chargee has had no notice of negative pledge prohibitions. Charges may be granted over future property.
- Charges over choses in action are usually drafted as an assignment by way of security – although the courts make little distinction between (1) charges and (2) assignments by way of security.

c Pledge (by way of transfer of possession of tangible property).

d Lien (by way of the lienholder retaining possession of tangible property).

The typical ways of taking security over real estate; tangible moveable property; shares and financial instruments; contractual rights and receivables; and intellectual property rights are described below.

Real estate

Security over Hong Kong real estate is often given by way of fixed legal charge (whereas security over choses in action related to the property is given by way of assignment). Although lenders are not required to adopt any specific mortgage form, the Hong Kong Mortgage Corporation Limited has introduced a set of standard form model mortgage documents in respect of residential properties.

Security granted over a registrable interest in land must be registered with the Land Registry.

Tangible moveable property

Security over tangible moveable property is often given by way of fixed or floating charge:

a Fixed charge: A fixed charge is created over a particular identified property (which may include future property). The chargee's consent is required for the chargor to dispose of the property free from the charge. If the chargor defaults, the chargee may enforce the charge by selling the property. Typically, the chargee will appoint a third party receiver to enforce the charge, in order to protect the chargee from potential liability arising from enforcement.

b Floating charge: A floating charge is similar to a fixed charge but is created over a moving class of assets (such as stock), which may change from time to time. Unlike a fixed charge, the chargor may dispose of the charged assets and carry on its business as usual until an event (such as acceleration under an event of default) occurs that crystallises the floating charge into a fixed charge. Floating charges rank behind fixed charges granted (before floating charge crystallisation) over the same property.

To reduce the risk of tangible charged property being sold to a *bona fide* purchaser of the legal estate without notice of the charge, where possible, plaques should be attached to the charged property to give notice to third parties of the existence of the charge.

Shares and financial instruments

Security over shares and financial instruments is often given by way of fixed or floating charge.

The charging language used will depend upon whether the shares are held directly in certificated form or held indirectly via a nominee or custodian.

In the case of a charge over Hong Kong shares held directly in certificated form, the chargor will transfer the share certificate to the chargee and execute a blank form of instrument of transfer and a blank sale contract note, which the chargee may complete upon enforcement and use to transfer the shares to a third party. The chargee may also ask the chargor to arrange for the signature – by the directors of the underlying company whose shares are charged – of certain undated board resolutions and undated resignation letters of directors, with authority for the chargee to complete these documents upon enforcement.

Unless the share charge extends to a charge over dividends, notice is typically not sent to the company whose shares are charged as this will not affect priorities (Section 634 of the Companies Ordinance states that no notice of trust may be entered in a Hong Kong company's register of members). This means that, under a share charge, a chargee is exposed to the risk of a chargor transferring legal title to the charged shares to a *bona fide* purchaser without notice. Such a *bona fide* purchaser without notice would likely take the shares free of the charge. It should be noted that although the chargee holds the share certificate, the chargor may apply to the company for a new share certificate on the basis that the previous share certificate has been lost or destroyed. Although there is a court process under which a 'stop notice' may be served by the chargee on the underlying company whose shares are charged, requiring the underlying company to give notice to the chargee if the chargor attempts to transfer the shares, this process is rarely used.

When taking security over shares and financial instruments, the terms governing the underlying shares or instrument must be checked to ensure there are no provisions prohibiting transfer (and, if there are, those provisions should be amended).

In the case of a charge over shares held indirectly via a nominee or custodian, the charging language is more similar to that used for contractual rights and receivables (described below). Notice of the share charge should be sent to the nominee or custodian to preserve priority.

For other financial instruments, notice of a charge should usually be given to preserve priority (with the notice given to the person who either owns the instrument on behalf of the chargor, or to the payor under the instrument, as applicable).

Contractual rights and receivables

Security over contractual rights and receivables is usually drafted in the form of an assignment by way of security. Courts make little distinction between a fixed charge and an assignment by way of security.

As for shares and other instruments, the terms of the contractual rights and receivables should be reviewed to ensure there are no provisions prohibiting transfer (and, if there are, those provisions should be amended).

Notice of charge should be given to the debtor or payor to which the contractual rights and receivables relate in order to preserve priority.

Intellectual property rights

Hong Kong has specific registries for patents, trademarks and designs, although there is no registry for copyright.

Security is usually taken in the form of a mortgage, or charge or assignment, by way of security.

Security over registered intellectual property should be registered at the Hong Kong Patents Registry, the Trade Marks Registry or the Designs Registry. If the security is not registered, it is ineffective against certain acquirers who acquire the intellectual property without notice of the security. There is no legal requirement to make the registrations within a specified time, although late registration may impact upon damages claims as well as priority and perfection against third parties.

Formalities

Hong Kong real estate – Land Registry

Security over Hong Kong real estate (if registrable) must be registered with the Land Registry to protect its priority. If the document is registered within one month of execution, it takes priority from the date of execution. Late registrations will take priority from the date of registration.

Companies Registry

Where the grantor is (1) a Hong Kong-incorporated company; or (2) a non-Hong Kong company that is registered at the Companies Registry (usually required by reason of having a place of business in Hong Kong) that is granting security over Hong Kong property, then specified types of security must be registered with the Companies Registry within one month of execution. Otherwise, the security will be void against any creditor or liquidator and the chargor company (and certain of its officers) will commit an offence.

The more common types of security that must be registered include:

a security over any property where the security granted is a floating charge;

b security over chattels;
c security over land;
d security over book debts (but excluding bank accounts);
e security over ships;
f security over aircraft; and
g security over goodwill, patents, trademarks and copyright.

The full list of securities that must be registered is set out in Section 334 of the Companies Ordinance.

Note that although security over a bank account is not registrable as book debts, it will be registrable if the security is a floating charge. The question of characterisation of security is both a matter of form and substance. A factor to take into account will be the nature of the dealings and interactions between the chargor and chargee.

Registration requirements also apply where an asset is acquired that is subject to security.

IP registers

Security over patents, registered designs and trademarks are subject to specific registrations:

a security over patents and registered designs must be recorded at the Hong Kong Patents Registry by filing Form P19 or the Designs Registry by filing Form D5; and
b security over a registered trademark must be registered with the Trade Marks Registry by filing Form T10.

An unregistered security interest over a registered patent, design or trademark is ineffective against certain acquirers who did not have notice of the security interest at the time of acquisition.

Aircraft

Although there is no statutory duty to do so, market practice is to notify the Civil Aviation Department in Hong Kong of the security interest, and to include chargee details on the nameplate of the aircraft, in order to give notice of the security interest to third parties.

Ships

Security over ships is usually by way of mortgage. A mortgage over a Hong Kong-registered ship must be in a prescribed form and registered with the Hong Kong Shipping Registry. Priority is accorded from the time of registration.

ii Guarantees and other forms of credit support

Guarantees are commonly used in Hong Kong as a form of credit enhancement. Market documentation prepared by the Asia Pacific Loan Market Association includes loan facility agreements with integrated guarantee provisions.

Other credit support techniques that may be used include sale and leasebacks, transfer of collateral with an obligation to return the same (or equivalent) collateral, disposal of receivables with recourse remaining against the transferor, retention of title arrangements and contractual set-off arrangements.

Negative pledge undertakings are usually included in loan facility agreements. Breach by a borrower of a negative pledge entitles the lender to bring a damages claim as an unsecured creditor, but breach is unlikely to disturb the security granted in favour of a *bona fide* third party created in breach of the negative pledge.

iii Priorities and subordination

Subordination of debts

A lender may commonly seek subordination of debt owed by the borrower to creditor shareholders, so that the lender's loan ranks in priority to the creditor shareholders' loans. Such subordination is effected by way of contact, often by way of deed of subordination between the borrower, the lender and the creditor shareholders.

Structural subordination is also permissible.

Priority of competing security interests

Priority is a complex matter that depends upon the particular facts and the relevant registrations (if any).

A common priority concern arises where a company grants security by way of two fixed charges over the same debt chose in action to two creditors. The starting point under common law is that the creditor who gives notice first to the debtor takes priority over the other creditor. If that fixed charge is registrable at Companies Registry, then to preserve priority the fixed charge must be registered within the required time period of one month after execution (the time period is a shortened period brought into effect on 3 March 2014 under Hong Kong's new consolidated Companies Ordinance legislation). The new Companies Ordinance legislation also changes the previous regime by requiring that the instrument of charge must be registered in full. The text of the instrument of charge is therefore available to the public for a small fee.

Although it is unclear how these changes under the new Companies Ordinance legislation will effect the doctrine of notice, it is expected that registration of an instrument of charge will likely give rise to constructive notice of all the terms in the charge instrument – including negative pledge clauses – on the part of those who may reasonably be expected to search the companies register, including banks, financiers and relevant professionals. Reinforcing the previous sentence, Companies Registry has stated it is 'more important than ever' for lenders to make enquiries and search the companies register for charges. It would appear that, for example, where a company grants a charge over a debt chose in action to a 'first financial institution' and then subsequently grants a charge over the same debt chose in action to a 'second financial institution', then the first financial institution may take priority if the second financial institution would have been aware of the first financial institution's interest had it searched the Companies Registry's register (regardless of whether or not the first financial institution has given notice to the debtor). In a similar way, negative pledges in floating charges may now bind later financial institutions that have a fixed charge interest in the same asset.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Legal limitations on the validity or enforceability of lending and secured arrangements are described below.

If lenders (including via their agents) are put on notice that a borrower may not have properly convened and held the board meeting that authorised the relevant loan and security documents, then the court may find that the documents do not bind the company. Care needs to be taken by lenders' counsel that there are no irregularities that would put lenders on notice. A particular case (*Moulin Global Eyecare Holdings* [2010] 1 HKC 90) where the courts found a lender had notice of irregularities involved lender's counsel preparing draft board minutes and (as requested) including in those draft board meetings – prepared prior to the meeting – the list of specified directors of the borrower-listed company who were to attend the meeting. The specified directors were all connected to the controlling shareholder family, and none of the five non-executive directors (including three independent non-executive directors) were included in the list. In the circumstances, which included there being little time to give notice of the meeting to all directors, the court found that the loan and related security documents did not bind the borrower-listed company.

Previous legal opinion concerns with financial assistance, leading to loans and security being unenforceable, no longer apply for documentation entered into on or after 3 March 2014, when Hong Kong's new consolidated Companies Ordinance legislation came into effect. Financial assistance remains an offence, and so remains a concern for subsidiary guarantors and subsidiary security providers.

The way in which a non-Hong Kong corporate may execute Hong Kong law governed deeds (such as charges) is more restrictive than most common law jurisdictions. If execution is not by way of the affixation of a common seal or under a power of attorney that is valid in the corporate's place of incorporation, then a reservation may be made in a legal opinion. As from 3 March 2014, the procedure for a Hong Kong-incorporated company to execute a Hong Kong law-governed deed has been relaxed, but the relaxation does not apply to non-Hong Kong corporates.

Although there is no binding Hong Kong case law in this area, Hong Kong practice is to follow the *UK Mercury* case for the steps to take when executing a deed. If signature pages are executed as a deed and the executed signature pages are later attached to the rest of a document expressed to be a deed and governed by Hong Kong law, then a reservation may be made in a legal opinion.

Hong Kong law follows the doctrine of absolute Crown immunity (for the PRC but excluding Hong Kong), and the doctrine of absolute state immunity (for foreign states). Immunity cannot be waived by the parties by way of including a waiver in the underlying agreements. Legal opinions may therefore include assumptions that the parties are not Crown or foreign state entities.

Registry filings are made after the event and so are not up to date. The best evidence for ascertaining directors and members of a company can be found in the statutory books kept by the company, although these are not typically reviewed unless a shareholder is granting a charge over its holding of shares in the company.

Where security is granted, the prohibitions set out in the underlying asset being charged will impact upon whether or not the security can be realised. Obvious concerns are:

a a charge over shares in a company where company directors have discretion not to register a transfer of shares; and

b security over a contract where that contract does not permit parties to dispose of their interests.

Legal opinions usually set out the relevant registry filings that must be made upon creation of security, and then assume those filings will be made within the prescribed time limits.

Legal opinions cover the valid creation of security, but do not go further to describe the type and ranking of security given the complexities of this area of law.

VI LOAN TRADING

Loan trading is usually carried out by way of novation and assignment, and both methods are catered for in Asia Pacific Loan Market Association primary documentation. Sub-participations and synthetic methods are available but less commonly used.

VII OTHER ISSUES

If a lender is not an authorised institution licensed by the HKMA, then it may fall under the Money Lenders Ordinance (Chapter 163 of the Laws of Hong Kong) if it is carrying on a business in Hong Kong (whether itself or through agents) of making loans, or if it advertises or announces itself as carrying on that business. This legislation seeks to protect consumers against unfair credit transactions, for example, by requiring moneylenders to be licensed, and for moneylenders to use prescribed forms and not to charge compound interest. Breach of the Money Lenders Ordinance may result in the commitment of offences, and underlying transactions being unenforceable. A number of loans are exempted from the above requirements (including the requirement to be licensed in order to lend money). A commonly used exemption is for loans made to a company that has a paid up share capital of not less than HK$1 million (or its equivalent in another currency).

A lender who is not an authorised institution licensed by the HKMA must abide by the usury laws set out in the Money Lenders Ordinance, which requires loans and security not to be 'extortionate'. There is a statutory presumption that a transaction is extortionate where the effective rate of interest exceeds 48 per cent per annum.

VIII OUTLOOK AND CONCLUSIONS

Hong Kong's insolvency regime remains creditor-friendly, and there is no specific debtor resolution mechanism in place.

Hong Kong loan volumes remain high, and we expect the same to continue, although the increased prevalence of uncommitted facilities may impact on the use of committed facility agreements.

Chapter 11

INDIA

L Viswanathan and Dhananjay Kumar[1]

I OVERVIEW

The Indian lending market has traditionally been dominated by banks (both government-owned and private). Since 2014 however, a growing recognition by the Reserve Bank of India (RBI)[2] and banks of increasing non-performing assets (NPAs) and stressed assets[3] has put tremendous pressure on the banking sector, resulting in a deceleration in growth of loans and advances (especially by public sector banks).[4]

The RBI is making strong efforts to require banks to recognise early stress triggers in loan accounts in order to ensure adequate provisioning and timely recovery. Several positive measures have been introduced in the recent past. These include RBI-led schemes for effecting strategic turnaround of companies (with greater creditor control over management), liberalisation of the regime governing sale of stressed assets including to asset reconstruction companies (ARCs), notification of the Insolvency and Bankruptcy Code, 2016 (the Insolvency Code) and the RBI being empowered to direct banks to initiate proceedings against defaulting borrowers under the Insolvency Code.[5] The success of these measures, however, is yet to be fully ascertained.

Increasing stress in the banking sector has also led the RBI to discourage large borrowers from depending solely on the banking system for funding.[6] Simultaneously with efforts to reduce credit concentration in the banking sector, the RBI and the government of India have attempted to open up new lending avenues for Indian corporates, especially in the

1 L Viswanathan is the chair of finance and projects and Dhananjay Kumar is a partner at Cyril Amarchand Mangaldas. The authors acknowledge the help received from Surya Sreenivasan and Gautam Sundaresh.

2 The RBI is the central bank constituted under the Reserve Bank of India Act, 1934, which is accorded the statutory mandate to govern the functioning of the banking sector in India.

3 The estimated number of stressed assets has doubled since 2013. https://rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1035 (last accessed on 6 June 2017). At the direction of the RBI, proceedings have been initiated against 12 of the largest corporate defaulters by banks, with directions to resolve NPAs being issued by the RBI in respect of other defaulters (a six-month time period has been provided for such resolution, after which the RBI may refer these cases to insolvency proceedings).

4 RBI, Report on Trend and Progress of Banking in India 2015–16.

5 As per the Financial Stability Report of June 2017 released by the RBI, the gross NPAs of scheduled commercial banks rose from 9.2 per cent in September 2016 to 9.6 per cent in March 2017, with an estimated increase to 10.2 per cent in March 2018.

6 'Guidelines on Enhancing Credit Supply for Large Borrowers through Market Mechanism' notified on 25 August 2016 and effective from 1 April 2017. The RBI has also implemented the Basel Committee for Banking Supervision Standards on 'Supervisory framework for measuring and controlling large exposures' through its 'Large Exposures Framework', notified on 1 December 2016 and effective from 1 April 2019.

beleaguered infrastructure sector. A recent example of such efforts includes an amendment to enable foreign portfolio investors (FPIs) to invest in unlisted debt securities in India. There has also been a dedicated effort by the RBI to develop guidelines on the sale of stressed assets by banks to put in place a resilient framework for the sale of non-performing assets by banks to institutions that may be better able to recover those assets, such as securitisation vehicles or non-banking financial companies (NBFCs). As an outcome of these efforts, NBFCs and new lending entities (such as FPIs and alternative investment funds (AIFs)) have significantly increased their share in the market in recent times.

Structured lending has also taken off in a big way, with Indian corporates looking for new (and cheaper) sources of funding. Recent liberalisation in the foreign exchange regulations allow Indian corporates to attract more offshore investment, including through the introduction of 'masala bonds'(i.e., rupee denominated bonds issued offshore by Indian corporates). Given the volatility of the Indian rupee in recent times, these bonds have become popular, as they eliminate the currency risks associated with offshore borrowing.

Increasing instances of fire sales of stressed assets has seen a focus on acquisition finance. Many conglomerates are trying to reduce their debt levels by divesting and monetising cash flow from performing assets (with the Lanco group and Jaypee group being high-profile examples).

Indian creditors do not usually adopt Loan Market Association (LMA) or Asia Pacific Loan Market Association (APLMA) standard documentation, and each creditor may use its own format of loan documents.[7] Indian loan documentation is typically covenant-heavy on the borrower (especially in a special purpose vehicle or project financing).

II LEGAL AND REGULATORY DEVELOPMENTS

The increasing stress in the Indian banking sector has resulted in several reforms and regulatory measures in the past few months, aimed at requiring lenders to resolve and restructure bad loans to reduce the gross NPA ration. India has also seen several broad-based changes, such as constitution of the National Company Law Tribunal for companies, introduction of the new Insolvency Code and measures to regulate and bring transparency in setting interest rates by banks. This section contains a high-level summary of the main recent and regulatory developments.

i Regulation of lenders

Different types of creditors in India are subject to differing levels of government oversight and scrutiny. Banks in India are heavily regulated, with RBI guidelines governing interest rates, extent of exposure to corporate groups, information sharing and reporting requirements and other prudential aspects. Indian regulations permit NBFCs to engage in lending business if they register with the RBI, although NBFCs are subject to lesser scrutiny. In recent years, however, the RBI has introduced several measures aimed at reducing regulatory arbitrage between banks and NBFCs.[8] The past few years have also seen the introduction, by the RBI and the Securities and Exchange Board of India, of lightly regulated lending vehicles such as AIFs and FPIs in order to widen the Indian investment market.

7 The Indian Banks Association has notified some standard formats, the broad terms of which are adopted by lenders.

8 RBI, Report on Trend and Progress of Banking in India 2015–2016.

ii Restructuring schemes

In order to combat the growing NPA problem, the RBI introduced out-of-court schemes allowing banks to restructure their stressed assets, giving banks greater management and control over borrowers in the restructuring process. The strategic debt restructuring scheme (SDR)[9] allows banks to convert all or part of their loans into a majority equity stake in the borrower, take control of the borrower and sell the shares to a buyer to recover their loans. While this scheme has been invoked in 21 cases, only in two cases have the banks found buyers for the stressed borrowers at suitable valuations. The Scheme for Sustainable Structuring of Stressed Assets (S4A)[10] that allows banks to convert part of their debt into equity, while retaining a sustainable amount of debt to be repaid has been successfully implemented only in a couple of cases. Creditors routinely require borrowers to acknowledge their right to convert debt to equity under these schemes in the loan documentation.

iii Insolvency Code

The Insolvency Code (which became effective recently) provides a comprehensive framework dealing with the insolvency resolution process of corporate entities, and is a complete overhaul of the earlier insolvency regime. Creditors are now given a greater role in arriving at a resolution for the borrower. The provisions of the Insolvency Code which allow operational (trade) creditors to file proceedings against borrowers for smaller defaults has caused many creditors to strengthen cross-default clauses in loan documents, while also imposing stricter covenants on borrowers with respect to trade creditors.

vi Constitution of the National Company Law Tribunal

The National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT) were constituted in June 2016. These are meant to serve as a single window for all company law disputes, including insolvency proceedings, assuming powers previously exercised by High Courts, the Company Law Board and the Board of Industrial and Financial Reconstruction.

v Basel III

Basel III implementation has commenced in a staged manner in India, with full implementation expected by 31 March 2019. While it is generally expected that implementation of Basel III may increase lending rates, unlike LMA and APLMA jurisdictions, domestic creditors have not introduced a concept of 'increased costs' for Basel III implementation in loan documentation. Foreign creditors in India however adopt the LMA standard of reserving a right to claim increased costs from the borrower, subject usually to negotiated caps.

vi Sanctions and Anti-Corruption Laws

Sanctions and anti-corruption laws were previously broadly subsumed by Indian creditors within the representations and covenants on compliance with all applicable laws. In

9 Introduced by the RBI in June 2015.

10 Introduced by the RBI in June 2016.

recent times, based on recommendations of the Financial Action Task Force and the Basel Committee, the RBI has issued various guidelines on compliance by banks with these standards[11] in respect of monitoring accounts and reporting of suspicious activity.

Banks are also now subject to enhanced 'know your customer' (KYC) requirements, which are tailored to meet these guidelines. Most domestic banks require borrowers and security providers to complete a comprehensive KYC as a condition precedent to disbursement. International banks as well as domestic banks with a presence in the United States and the European Union may additionally require borrowers to comply with requirements of the Office of Foreign Assets Control regime or the relevant EU regime. Typically, creditors do not look to extend compliance requirements beyond these regimes (except in transaction-specific cases).

vii MCLR

While RBI guidelines permit banks and NBFCs to determine interest rates linked to market determined external benchmarks (such as the London Interbank Offered Rate), most domestic lenders adopt the 'marginal cost of funds based lending rate' (MCLR). In April 2016, the RBI replaced the existing interest rate system with the MCLR. Under the MCLR, the lending rate is also pegged against change in rates and costs of borrowing by banks, including the repo rate. The MCLR adopts a tenor-based benchmark, and the final lending rate offered to individual borrowers includes the 'spread' over and above the MCLR.

III TAX CONSIDERATIONS

i Indian withholding tax

An Indian borrower is required to withhold tax payable by a non-resident creditor on interest. Interest payable on a foreign currency denominated loan is subject to a withholding tax of 20 per cent (plus applicable surcharge and cess[12]), while interest on a rupee-denominated loan is subject to withholding tax of 40 per cent (plus applicable surcharge and cess). A lower withholding tax rate of 5 per cent (plus applicable surcharge and cess) may be available where an Indian company avails itself of a long term foreign currency loan, or issues long term foreign currency or rupee denominated bonds, subject to fulfilment of certain prescribed conditions linked to the Indian exchange control regulations.[13] Interest on loans to Indian borrowers outside India for their offshore businesses are not subject to withholding in India, while loans taken out in India are subject to withholding taxes.

Indian tax laws also offer lower withholding tax rates to certain foreign investors who qualify as FPIs. Generally, FPIs suffer a withholding tax of 20 per cent (plus applicable surcharge and cess) in case of interest from any securities. However, a lower withholding tax rate of 5 per cent (plus applicable surcharge and cess) applies in case of payment of interest on rupee-denominated bonds of an Indian company.[14]

11 Consolidated in the RBI Master Direction – 'Know Your Customer' Direction dated 25 February 2016.

12 Surcharge may be zero per cent, 2 per cent or 5 per cent depending on the income thresholds. Rate of cess will be 3 per cent.

13 This reduced rate of withholding tax is applicable until 30 June 2020.

14 Subject to fulfilment of certain conditions. Also, this reduced rate of withholding tax is applicable until 20 June 2020.

Non-resident creditors and FPIs may also be eligible to avail themselves of beneficial tax rates available under India's vast array of double tax avoidance agreements (DTAAs). Certain DTAAs exempt interest income from tax, should the interest be paid to certain specified creditors (such as government, specified governmental agencies, financial institutions and statutory or local authorities etc.). The rate of withholding tax on interest varies from 7.5 per cent to 40 per cent as per the DTAAs executed by India.

The introduction of the Goods and Services Tax in India may impact the cost of lending, since increased service tax will be leviable on banking services.

ii Documentary and transfer taxes

Documentary (or stamp) taxes are payable on every document signed in India or signed outside India but brought into India (including in some states, in electronic form). Therefore, if creditors anticipate a document being brought into India (for instance, to enforce), stamp duty is usually paid at the time of signing. Rates of stamp duty on most documents are determined by the respective state governments for where the document is to be executed or for the location of the immoveable property concerned. While some states (such as Delhi, Gujarat, Telangana and Andhra Pradesh) have lower stamp duty rates (with loan agreements subject to rates between US$3 and US$10), states such as Maharashtra impose a significantly higher stamp duty, at 0.2 per cent of the amount being lent. The rate of stamp duty payable on various types of security interests also varies significantly (from US$0.15 in Andhra Pradesh to US$15,500 in Karnataka) and is a consideration for creditors while choosing their security package. Following a 2015 judgment of the Supreme Court of India,[15] although collateral is created in favour of a single agent or trustee in consortium lending, security documents are required to be stamped as though executed separately in favour of each creditor.

Loan trading transactions attract stamp duty. While novation of commitment may attract a nominal stamp duty (since stamp duty is already paid on the loan agreement), stamp duty on an agreement for assignment of a loan and receivables (being treated as a conveyance of moveables) attracts stamp duty ranging from 3 per cent to 14 per cent of the loan amount being assigned. In order to give a boost to the securitisation market in the country, however, the legislature has recently exempted securitisation transactions involving the transfer of rights or interest of banks or financial institutions in financial assets from stamp duty incidence.

Typically, the adequacy of stamp duty on instruments is tested when: (1) they are sought to be registered or otherwise presented to a public authority who has the authority to impound such documents under the stamp laws; or (2) they are sought to be enforced or relied on as evidence (in court proceedings or private dispute resolution proceedings such as arbitration).

While the obligation to pay stamp duty is usually borne by the borrower under loan documentation, in the State of Maharashtra, creditors are liable to pay a penalty equal to the stamp duty on any instrument creating rights in their favour that is inadequately stamped. Documentation is typically structured in a manner that minimises stamp duty incidence (such as by executing in states that have a lower stamp duty rate and agreeing to jurisdiction clauses of such state).

15 *Chief Controlling Revenue Authority v. Coastal Gujarat Power Limited & Ors*, Civil Appeal No. 6054 of 2015 (arising out of SLP (C) No. 32319 of 2013).

FATCA and CRS

From 2015, the Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) have become applicable in India, under the inter-governmental agreements executed by the Indian government. These arrangements have been implemented in India by requiring financial institutions to share relevant data with the Central Board of Direct Taxes, which will then transmit this information to the relevant offshore authorities. The RBI has also modified its KYC and reporting guidelines applicable to lending institutions to incorporate the FATCA and CRS requirements. Creditors typically address FATCA compliance by requiring the borrower and other creditors to confirm their FATCA status, and each party bears its own FATCA deductions, with no gross up (similar to the LMA arrangements on FATCA).

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Types of security interest

Creditors can choose from a variety of security options to safeguard their exposure to borrowers and minimise risks associated with lending in India. Typically, high-value transactions involve the creation of multilayered security packages. While creditors may have preference for the type of security that is to be created, industry, and company-specific diligence plays a key role in charting out strategy for assets to be secured as well as the type of security interest to be created, in order to ensure the highest degree of protection.

Mortgages

A mortgage is a transfer of interest in immoveable property to secure an existing or future debt or the performance of an engagement which may give rise to a pecuniary liability. While there are different types of mortgages that may be created in India (such as usufructuary mortgage, mortgage by conditional sale), in secured lending transactions involving immoveable property as security, typically a mortgage in the English form or by deposit of title deeds is created. Many traditional lending institutions in India still require a borrower to mortgage some immoveable property for any lending, since this is seen to provide a greater assurance than security over moveable or financial assets. Working capital is typically secured by receivables and the stock-in-trade of the borrower.

A mortgage in English form is the preferred form of security, since it involves a complete transfer of property to the creditor subject to the right of redemption of the mortgagee. It is typically associated with ease of enforcement, since a creditor has private remedies available (such as appointment of a receiver for the property) under law and does not have to rely on a court process for protection or enforcement of security. There is ambiguity regarding whether such remedies are available to foreign creditors, however. Legal structuring of a mortgage in English form allows borrowers to charge or assign moveables, contracts and other assets along with the immoveable property, affording the benefit of private remedies and ease of mortgage enforcement to all such assets. A mortgage in English form can, thus, effectively secure all assets of the borrower.

A mortgage by deposit of title deeds requires the deposit of title deeds of the property with the creditor with an intention to create security over such property (usually demonstrated by a declaration issued by the borrower at the time of deposit of the title deeds). Such mortgage can be created only over immoveable property and, therefore, does not afford the convenience of stapled security unlike a mortgage in English form.

Pledge and lien

A pledge is a special form of 'bailment' under law and, therefore, requires actual or constructive delivery of possession of the assets being pledged. Since transfer of possession restricts the ability of the borrower to use the secured assets, a pledge is usually created over shares and financial assets, which are not required for day-to-day operations. Such a pledge is created by handover of the share or security certificates to the creditor, or if the securities are in electronic form, by the marking of a pledge over the securities in the records of the depository,[16] which 'locks' the securities and does not permit any transaction without the consent of the creditor. Pledges are usually accompanied by a power of attorney in favour of the creditor (or the trustee) for exercise of rights in respect of the securities on the occurrence of a default.

Pledges are taken as security in all kinds of financing, including project financing and mezzanine or structured financing, since they allow borrowers to leverage financial securities held by them and provide ease of enforcement. Upon a default by the pledgor, a sale of the pledged assets can be effected without court intervention, and the proceeds can be used by the pledgee to discharge the pledgor or borrower of its obligations.

Indian law also recognises retention of title clauses and provides for security in the form of a lien to unpaid sellers.

Charge and Hypothecation

While moveable assets are frequently 'stapled' with immoveable property in an English mortgage (see section on Mortgages, *supra*), where immoveable property is not available or is being secured by a mortgage by deposit of title deeds, creditors require the borrower to charge its moveable assets (physical assets, financial assets and non-physical assets) under a hypothecation document. While a standalone mortgage over moveable properties has also been recognised, this is not the usual route adopted by creditors in India. A hypothecation is recognised in Indian law as a charge on existing or future moveable property without delivery of possession. It is a contractual creation of a special property in assets, entitling the creditor to take possession of those assets in a default and sell them for realisation of outstanding debt. Both fixed and floating charges are recognised in India.

Substitution Rights

In most public-private partnership projects (e.g., roads and airports), the government continues to own the project asset, with a concession being granted to the borrower to develop and operate the asset. Similarly, several assets such as telecom, spectrum, mining rights etc. are owned by the government and licensed to private parties. These assets cannot be charged directly to creditors. Therefore, government authorities enter into tripartite

16 A depository is an entity registered with the Securities and Exchange Board of India to hold dematerialised securities in its system and maintain records for the beneficial owners of such securities.

arrangements with creditors, under which they allow the creditors a right to substitute the borrower with an eligible third party (subject to certain conditions). However, the sanctity of such arrangements is not clear.

Common methods of taking security

The most common types of security interests associated with certain types of assets are:

- *a* real estate: by way of a mortgage over immoveable property, which may also encompass all other assets of the borrower under a stapled security structure;
- *b* tangible moveable property: by way of a mortgage (if stapled with land) or a hypothecation;
- *c* financial securities: usually by way of a pledge, delivering possession to the creditors; and
- *d* contractual rights, receivables, intellectual property, etc., by way of a mortgage (if stapled with land) or a hypothecation. Additional perfection rights may be required depending on the nature of the asset (e.g., creation of charge over aircraft is required to be endorsed on the certificate of registration with the Directorate-General of Civil Aviation). With respect to intellectual property, creation of any security interest is required to be notified to the relevant registration authorities.

Foreign creditors also require a no-objection certificate from the relevant authorised dealer (AD)[17] prior to creation of security over any Indian assets in their favour.

Common methods of enforcement

Enforcement of a security interest may be done either privately or through court intervention. A typical private enforcement process would take about two to four years, whereas a court process may extend to about 10 to 12 years.

A mortgagee has the right to file a suit for foreclosure or sale on default in repayment; however, such rights have not been extended to foreign creditors under the Indian transfer of property regime. Thus, while foreclosure is not an option for mortgages in English form or foreign creditors, creditors holding a mortgage in English form are permitted to effect a private sale of the property or appoint a private receiver without approaching a court. The enforcement of a charge over moveable assets requires the intervention of courts unless the terms of the underlying contract expressly provides for it. For a pledge, a creditor may simply sell the pledged assets in accordance with the terms of the underlying contract and after giving reasonable notice to the pledgor. Creditors have a duty to maximise recovery from secured assets.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) provides creditors private remedies to enforce any security interest (except a pledge on moveable assets or a lien). Where a substantial part of the business is held as collateral by the creditors (such as in a project financing), they are also permitted to take over the management of the borrower. In cases of consortium lending, approval of 60 per cent of the creditors in value is required for exercise of powers under the SARFAESI

17 AD banks are banks which are authorised by the RBI to deal in foreign exchange in India.

Act, and such approval is binding on all creditors (including dissenting creditors). By way of recent amendments, the remedies under the SARFAESI Act have also been extended to the listed bond market in India.

Debt recovery tribunals (DRTs) have been established in India under the Recovery of Debts and Bankruptcy Insolvency Resolution and Bankruptcy of Individuals and Partnership Firms Act, 1993. Creditors (including secured creditors who have not received full repayment from enforcement of security) may apply to the DRTs for recovery of debt. Recovery officers of the DRT are empowered to, *inter alia*, attach property of the borrower (even such property which is not offered as collateral) and require third-party debtors of the borrower to repay debt amounts to the officer. The efficacy of approaching the DRTs to seek recovery of debt is severely hampered by an immense backlog of cases. It is estimated that there are over 70,000 cases pending before the various DRTs.[18] It has also been a common grievance that the officers appointed to such tribunals are highly inexperienced and lack the requisite training to adjudicate on debt-related issues.

Under extant foreign exchange regulations, foreign creditors require AD approval for enforcement of security and repatriation of proceeds. Further, enforcement would also need to comply with generally applicable foreign exchange restrictions, including that the sale of immoveable property can only be to a resident and any invocation of pledge is to be in accordance with the foreign investment policies.

Formalities and registration

Board approval

Any creation of security over a company's assets needs the approval of the Board of directors of the company, by way of a physical meeting. Creation of security over assets exceeding specified valuation thresholds also requires approval of three-quarters of the shareholders of a company. In case of third party security, additional corporate compliances are required, including demonstrating that such collateral is being provided in the ordinary course of business, or that the party for whose benefit it is being provided is not a related party (such as, for instance, that there are no common directors).

Stamping

See Section III, *supra*.

Registration

All charges (including mortgages, pledges, lien, etc.) created over the property and assets of a company are to be registered with the Registrar of Companies within 300 days of the date of creation of the charge for the security interest to be enforceable *vis-à-vis* the company's creditors and its liquidator, for a fee ranging between US$3 and US$9.

Mortgages over immoveable property (other than by way of deposit of title deeds) are also required to be registered with the sub-registrar of assurances in whose jurisdiction the property is situated. The registration fee varies across various states and may either be a

18 http://ibbi.gov.in/16_Joint_Committee_on_Insolvency_and_Bankruptcy_Code_2015_1.pdf (last accessed 1 June 2017).

capped amount (US$461 in Maharashtra) or *ad valorem* in respect of the amount secured. Mortgages by deposit of title deeds are required to be noted in the land registry in certain states.

Creditors are required to file details of mortgages created in their favour with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) under the SARFAESI Act. Additionally, specific assets may also require additional registration (for instance, the assignment or transmission of rights in relation to patents is required to be filed in the register of patents). By way of a recent amendment to the SARFAESI Act, it was proposed that the Central Government integrate all registration systems for recording security interests over all types of assets (which are currently regulated under diverse legislations such as the Companies Act, 2013, the Merchant Shipping Act, 1958 and the Patents Act, 1970) with the CERSAI. This integration process has not yet been made effective.

Particular challenges

Some of the specific challenges faced by creditors in the creation and enforcement of security in India are as follows:

a requirement of government consent for creation and enforcement of security. Consent of local authorities may be required in some states for mortgaging land, particularly if the creditor is not a recognised/notified creditor. Certain assets (such as production-sharing contracts or mining leases) require government approval for creation and enforcement of any security, and enforcement is also possible against a limited number of entities. Similarly, forest land cannot be mortgaged, as it belongs to the government and approval is required even for the removal of immoveable plant and machinery located on it (which may itself be charged to the creditor). Securing government approvals may require approval of the relevant authority, and any transfer on enforcement may only be in favour of a similarly qualified entity;

b transaction costs remain high on account of stamp and registration duties;

c private enforcement is limited to only certain types of creditors, and enforcement proceedings through the court process are highly protracted, resulting in a diminution in the value of the assets over time; and

d under Indian transfer of property laws, there may be dual ownership over fixed assets and the land on which such assets are located. This creates complications for the purposes of enforcement of security by creditors.

ii Guarantees and other forms of credit support

Corporate guarantees are usually sought by creditors from the parent or from associated companies of the borrower entity. Although guarantees are executed as deeds (and, therefore, do not require consideration to pass to the guarantor), most creditors require the guarantor to demonstrate consideration in the form of a corporate benefit accruing to it.

Given India's traditionally promoter-driven corporate market, many creditors require individual promoters to provide personal guarantees for corporate loans. Creditors also require promoters to provide personal guarantees as a condition of restructuring loans (including under the RBI's SDR guidelines), on the principle that shareholders should bear the first loss. In view of the burgeoning NPA problem (see Section I, *supra*), the RBI in 2014 allowed banks to classify guarantors who refuse to honour guarantees as 'wilful defaulters', restricting access to capital and debt markets. With the increasing focus on guarantors by both banks and regulators, many corporate groups resist guarantees by individual promoters.

Group company guarantees require a host of corporate compliances to be met, including that the guarantor and the borrower should not have common directors and approval of the shareholders of the guarantor.

iii Priorities and subordination

As is the norm globally and with the changing landscape of insolvency laws in India, secured creditors continue to have better protection and preferential access to borrower assets than unsecured creditors.[19] Certain encumbrances created under law also have priority over secured creditor rights (such as banker's lien and an unpaid vendor's lien). Since these rely on a preferential status by virtue of possession, priority rules gain significance in the context of non-possessory securities (such as charges and mortgage).

In the absence of contractual provisions to the contrary, the following rules of priority are applicable under Indian law:

a between two registered charges, the charge registered prior in time will have priority;
b an equitable mortgage takes effect against any mortgage deed subsequently executed and registered in relation to the same property;
c a mortgage of moveables with possession has priority over a prior mortgage without possession;
d a mortgagee of moveable property without possession that comes to court first, will have priority over subsequent such mortgagees that approach the court;
e a fixed charge has priority over a floating charge;
f between two floating charges, the one created earlier in time will have priority; and
g the registration and fulfilment of perfection requirements of a charge give it priority over a non-registered and non-perfected charge, notwithstanding when the charge was created.

Contractual priorities in security are usually set out in an intercreditor or subordination agreement between the creditors. Intercreditor arrangements include turnover provisions (requiring subordinated creditors to turn over any out-of-turn recoveries to senior creditors) and trust provisions (whereunder subordinated creditors agree that any out-of-turn recoveries will be held in trust for senior creditors). Intercreditor arrangements are fairly standard and are afforded sanctity by courts as well as participating lending institutions. It remains to be tested whether turnover subordination provisions will be binding on a liquidator appointed under the Insolvency Code or the Companies Act, 2013.

Typical LMA and APLMA provisions requiring majority creditor consent for enforcement or other action against a borrower or obligor are viewed as unenforceable under Indian law, since the Indian Contract Act, 1872 holds contracts restraining legal proceedings to be void. Therefore, enforcement priority in India is maintained by imposing wait periods (up to a year) on subordinated creditors for enforcement.

An intercreditor arrangement may become problematic when different types of creditors are party to it, since all creditors do not have equal access to special enforcement mechanisms. For instance, remedies under the SARFAESI Act are not available to foreign creditors who are not registered in India and to certain NBFCs. The imposition of wait periods for access to

19 Under the Insolvency Code, secured creditors have the option of enforcing their security interests without relinquishing the same to the liquidation estate. In such scenarios, the unpaid debt of secured creditors ranks at par with government dues and below unsecured financial creditors under the liquidation waterfall.

remedies under the SARFAESI Act also entitles some creditors to invoke remedies under the SARFAESI Act before others. While an intercreditor arrangement may address these issues by requiring creditors who have the benefit of these regimes to share recoveries with other creditors, this results in an unsatisfactory situation where the notified creditors can then not recover their dues as they have (notionally) already received full payment from the borrower.

Recent RBI guidelines mandate the formation of a 'joint lender's forum' (JLF) comprising all creditors, when certain stress triggers are met.[20] While such fora may include foreign creditors, it is not mandatory for creditors who are not subject to RBI regulation to be a part of a JLF. All members of such a joint forum are required to sign an intercreditor agreement to govern priority, voting and decision-making; however preexisting agreements between JLF members are usually honoured.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Limitations on the validity and enforceability of guarantees and security

Although India broadly adopts a pro-creditor approach in ensuring the least possible hindrance in the enforcement of security interests and guarantees, there are certain limitations to enforceability that find their origin in law and apply in a universal fashion. These include the necessity of demonstrating a corporate benefit, aspects pertaining to financial assistance and the existence of clawback risks in the context of insolvency. These issues have been elaborated upon in more detail below.

ii Corporate benefit

A corporate benefit is required to be demonstrated in different ways, depending on the type of transaction being entered into and the person or entity to whom loans are being advanced or on behalf of whom security interests are being created (e.g., in favour of lenders). There applies a blanket prohibition on loans being advanced or security being created by a company in favour of its own directors or persons in whom the directors are interested. The exceptions to this rule include the provision of loans or security as part of the service ordinarily extended by the company to its employees or pursuant to a scheme expressly approved by the members of the company.

Financial assistance

The Companies Act, 2013 restricts public companies from giving loans or guarantees, or providing security or any financial assistance in connection with the purchase or subscription of shares by any person (including any shares in its holding company).

Clawback risks

As the insolvency regime applicable to corporate entities is spread over the provisions of the Companies Act, 2013 and the Insolvency Code, there are several clawback risks that apply depending on the framework under which the relevant antecedent transaction is being scrutinised. These have been set out in the table below:

20 Currently required for categorisation of asset as 'SMA-2' in the books of the creditor (i.e., where the principal or interest payment has been overdue between 61–90 days).

Antecedent transaction	Counterparty to the transaction	Effect	Look-back period	Consequence	Who may apply
Fraudulent preference under the Companies Act, 2013	Creditor, surety or guarantor	Puts person in better position in liquidation than would be if no preference given	Six months prior to making of winding up application	The NCLT may restore position to what it would have been if no preference given	*Suo moto*
Transfers not in good faith under the Companies Act, 2013	A purchaser or encumbrancer in good faith	A transfer of property or delivery of goods not being a transfer or delivery made in the ordinary course of business	One year before presentation of a petition for winding up by the NCLT	The NCLT would deem such transfer or delivery void against the company liquidator	*Suo moto*
Creation of a floating charge under the Companies Act, 2013	Any person	Creation of a floating charge on the undertaking or property of the company, unless it is proved that the company was solvent immediately after the creation of the floating charge	One year before presentation of a petition for winding up by the NCLT	The NCLT would deem such floating charge invalid except to the extent of any money paid in consideration for the charge together with interest on this amount	
Disclaimer of onerous property under the Companies Act, 2013	Any person party to a land of any tenure, shares, non-saleable property or unprofitable contract	Onerous on the company	N/A	The NCLT may allow the official liquidator to disclaim such property	Official liquidator
Preferential transactions under the Insolvency Code	Creditor, surety or guarantor	Transfer of property or an interest thereof on account of an antecedent financial liability, operational debt or other liability owed by corporate debtor having an effect of putting person in a better position than under waterfall mechanism under Section 53	Related party: during period of two years preceding insolvency commencement date Other than related party: during period of one year preceding insolvency commencement date	Avoidance of preferential transactions or any order made by the Tribunal under Section 44 of the Code	Liquidator or resolution professional
Undervalued transactions under the Insolvency Code If the transaction was deliberately entered into by the company to keep assets beyond the reach of creditors or adversely affect a person's claims, such transaction can be treated as a transaction defrauding creditors.	Any person	A gift is made to a person; or A transaction is entered into that involves transfer of one or more assets or consideration that is significantly less than the value of consideration provided by corporate debtor.	Related party: during period of two years preceding insolvency commencement date Other than related party: during period of one year preceding insolvency commencement date	Declaration of transaction as void or reversal of effect of transaction (as provided under Section 48), release of security created or return of benefits	Liquidator, resolution professional, or creditor, member or partner of the corporate debtor

Extortionate credit transaction under the Insolvency Code	Any person other than financial service companies	Requires the company to pay exorbitant payments for credit provided or is unconscionable under laws of contracts	Two years from insolvency commencement date	Set aside the transaction, restore the position or modify the transaction	Liquidator or resolution professional

v Legal opinions practice

The issuance of legal opinions is standard practice for the purposes of Indian lending. Such opinions usually contain statements regarding the capacity of the counterparty to execute the necessary documentation and to enter into the transaction. For the purposes of secured lending, such opinions also explicitly comment on the validity of the security interest being created. It is the creditors' counsel who usually delivers such opinions. However, in some cases, opinions are sought from the borrower's counsel along with a supporting confirmation from the creditors' counsel.

vi Choice of Law

Decrees passed by courts of a 'reciprocating territory' may be executed in India as Indian decrees, except in certain limited circumstances (for example, where the judgment has not been pronounced by a court of competent jurisdiction, where it has not been given on the merits of the case or where it appears on its face to be founded on an incorrect view of international law). The government notifies jurisdictions that qualify as 'reciprocating territories' by way of notification in the Official Gazette. So far only 12 jurisdictions have been notified as reciprocating territories, and this list does not include several key jurisdictions, including the US. Judgments or decrees of courts in non-reciprocating territories can be enforced only by filing a lawsuit in an Indian Court for a judgment based on the foreign judgment.

It is also relevant to mention here that certain changes have recently been carried out to the framework governing domestic and international arbitration. By way of these amendments, the scope for challenging a foreign award on the basis of violation of public policy has been narrowed, and awards have been prohibited from being set aside merely on the ground of an erroneous application of the law or by way of re-appreciation of evidence.

VI LOAN TRADING

Loan trading is common in India, with most documentation structures providing for loan trading without borrower consent by way of novation (usually of undisbursed commitment) and assignment (of a disbursed facility). Large loans involve agent and security trustee structures, allowing new creditors the benefit of existing collateral without requiring action on the part of the borrower. In the event of trading of bilateral loans, however, a release and recreation of security with the cooperation of the borrower is inevitable, which has also its own stamp taxes and registration cost implications. See section III, *supra* for a more detailed analysis.

Sub-participation and risk participation without a change to the creditor on record have seen an increase in Indian markets in light of the NPA issue, the market having been estimated to have grown by over 45 per cent in the financial year 2015–2016 and being worth over US$4 billion.[21] This has encouraged banks to trade stressed assets. Securitisation (i.e. assignment of loans and receivables to ARCs that issue security receipts to holders) is governed by the SARFAESI Act, which contemplates transfer of stressed assets to ARCs, which would then undertake recovery measures against the borrower. There has been a big push to promote such entities by the RBI and the Indian government in the recent past, including liberalising foreign investment in such companies. Foreign investment by eligible FPIs is also now permitted in securitised debt instruments issued by ARCs.

In September 2016, the RBI permitted banks to sell their stressed assets to other creditors, NBFCs and financial institutions. As per these guidelines, 'scheduled commercial banks' are required to identify assets for sale on an annual basis and periodically review the classification of their financial assets. Banks are also required to invite public bids for the same, in order to attract more buyers and improve the price discovery mechanism. Banks have also now been permitted to buy back financial assets which have been successfully restructured by ARCs (other than those which were sold by the banks themselves).

VII OTHER ISSUES

There are certain other issues under the current regulatory framework that act as impediments to entities or persons looking to lend in India. Some of these issues are specific to foreign creditors, while others affect domestic and foreign creditors alike.

Some of the issues that impact creditors include the 'lock-in' that applies to FPIs, which are permitted to invest in unlisted corporate debt securities only subject to a minimum residual maturity of three years and several end-use restrictions (the lock-in restrictions do not apply to investments in securitised debt instruments, however).

Besides this, there also apply several restrictions on remittances outside India. Any remittance of proceeds from the enforcement of security by a secured creditor may also require RBI approval.

Another recent development that creditors may need to be mindful of, is the notification of the Real Estate (Regulation and Development) Act, 2016, which provides for greater regulation of borrowers in the real estate sector and provides for, *inter alia*, stringent timelines for the completion of projects and for restrictions on the usage of money received from buyers for purposes other than for the development of the project. The empowered authority under the Act is authorised to revoke the registration of promoters for contravention of provisions of the Act. Lenders to borrowers in the real estate sector may be required to enforce stricter compliance and escrow mechanisms.

VIII OUTLOOK AND CONCLUSIONS

The Indian lending market is currently in a state of transition, with creditors exploring new structures and avenues for lending on the one hand, and borrowers exploring new avenues for fund raising on the other.

We expect the market to take some time to settle following the recently introduced measures to tackle the NPA problem, with several banks still in the process of identifying and

21 www.indiainfoline.com/article/print/news-top-story/indian-securitization-market-grew-by-45-in-fy16-outlook-positive-in-fy17-116052400757_1.html (last accessed on 1 June 2017).

addressing bad loans. The growth of ARCs, the introduction of the Insolvency Code and the granting of greater powers to the RBI/Ministry of Finance, among other measures, are also likely to have a big impact on lending in India.

New institutions and sources of investments, such as masala bonds, high-yield bonds, mezzanine finance, etc., are also likely to affect traditional lending, with borrowers looking for cheaper funds from more lightly regulated institutions.

Chapter 12

INDONESIA

Sri H Rahayu and Indra Prawira[1]

I OVERVIEW

Infrastructure development has become the top priority for the government under President Joko 'Jokowi' Widodo. Total government spending for infrastructure in Indonesia increased by 51 per cent from US$11.7 billion in 2014 to US$15.5 billion in 2015.[2] The Jokowi administration is continuing with many initiatives intended to increase infrastructure spending to 2019.

According to the foreign debt statistics of 2017 released by Bank Indonesia (BI), Indonesia's foreign debt at the end of the first quarter of 2017 reached US$326.3 billion. Of this amount, the outstanding public sector foreign debt amounted to US$166.5 billion (51 per cent), while private sector foreign debt amounted to US$159.9 billion (49 per cent).

Private sector foreign debt position is concentrated in the finance, manufacturing, mining, electricity, gas and water supply sectors. These four sectors amounted to 76.5 per cent of the total private sector foreign debt.

Recent deal activity

One recent, significant deal in Indonesia's infrastructure financing is a loan agreement worth US$4.5 billion, signed in May 2017 by the China Development Bank (CDB) and the Indonesian-Chinese consortium PT Kereta Cepat Indonesia-China.[3] The loan will be used to fund a bullet train project in Indonesia, the country's first rapid-train rail link connecting its capital city, Jakarta, to the textile hub of Bandung. The loan facility is equal to 75 per cent of the estimated project cost of US$6 billion.

Another transaction worthy of note is a syndicated loan agreement amounting to US$916.8 million, signed in 2016 between Indonesia's state-owned electricity company, Perusahaan Listrik Negara (PLN) and state lenders Bank Mandiri, Bank Negara Indonesia and Bank Rakyat Indonesia. The loan will be used to fund a government project to build power plants to produce an additional 35,000 MW of electricity for the country.[4] Further, PLN plans to raise another US$1.5 billion by mid-2017 to fund the project through global bonds.

---

1 Sri H Rahayu is managing partner and Indra Prawira is an associate at Rahayu & Partners Law Offices.

2 PWC's annual Indonesian Infrastructure Report 2016.

3 Reuters, 'Indonesia, China consortium sign $4.5 billion loan for rail project', www.reuters.com/article/us-china-silkroad-indonesia-idUSKCN18B0RX.

4 The Jakarta Post, 'PLN secures Rp 12t loan from state lenders', www.thejakartapost.com/news/2016/09/10/pln-secures-rp-12t-loan-from-state-lenders.html.

II LEGAL AND REGULATORY DEVELOPMENTS

i First fintech lending Regulation in Indonesia

The Indonesian Financial Service Authority (*Otoritas Jasa Keuangan*) (OJK) has issued the first regulation on financial technology (fintech) lending activities in Indonesia, the OJK Regulation No. 77/POJK.01/2016 (OJK Regulation 77) dated 28 December 2016, concerning information technology-based lending services. This regulation is expected to support the growth of the fintech lending industry, or peer-to-peer (P2P) lending platforms in Indonesia as a new financing alternative to conventional financial services industries. It is also expected that P2P lending providers (Providers) will open access to overseas or domestic loans from various areas to the Indonesian general public as part of government efforts to support the National Strategy of Financial Inclusion.[5]

The provisions of OJK Regulation 77 include organisational requirements on providers' obligations and restrictions related to lending services.

Organisation of Providers

The entity of Providers can be established in the form of a limited liability company (*Perseroan Terbatas*) (PT) or as cooperatives. Providers in the form of a PT (PT Providers) are subject to the Indonesian Company Law (*Undang-Undang Perseroan Terbatas*).[6] PT Providers can be a domestic ownership company or a foreign investment company with a maximum direct or indirect foreign ownership of 85 per cent total shares, while Providers in the form of cooperatives (Cooperatives Providers) must consist only of local members as required by Cooperatives Law No. 25 of 1992.

PT Providers must have a subscribed capital of at least 1 billion rupiah at the time of application for registration, to be increased to at least 2.5 billion rupiah when applying for the P2P lending licence.[7] This requirement also applies to Cooperatives Providers for minimum equity capital.

Registration and licence

The Provider must apply for registration to start P2P lending business activities to the OJK and apply for a licence at the latest one year after the issuance of the registration certificate.

Loans, lenders and borrowers

The maximum amount of loan that can be provided to each borrower is 2 billion rupiah. The regulation does not specify any maximum interest rates; however, the Provider may provide input on the interest rates proposed by the lender and the borrower in considering fairness and the development of the national economy. OJK Regulation 77 allows either local or foreign parties to be lenders, provided that certain offshore loan requirements apply under relevant regulations. Borrowers must be individual or legal entities originating and domiciled in Indonesia.

5 OJK press release dated 10 January 2017, 'OJK Issues Regulation on IT-Based Lending Services', www.ojk.go.id/en/berita-dan-kegiatan/siaran-pers/Pages/Press-Release-OJK-Issues-Regulation-on-IT-Based-Lending-Services.aspx.

6 Law Number 40 of 2007 dated 16 August 2007 on Company Law.

7 Current foreign exchange reference rate of Jakarta Interbank Spot Dollar Rate (JISDOR), US$1 = 13,290 rupiah.

Obligations and restrictions

OJK Regulation 77 provides obligations and restrictions to be complied by Providers and users (lenders and borrowers) in conducting P2P lending activities as follows:

Risk management

The Provider must provide an escrow account and a virtual account for managing P2P lending activities. The loans must be provided by lenders in virtual accounts, while the repayment of loans by borrowers must be paid through escrow accounts and is to be forwarded to the virtual accounts of lenders. Further, it is mandatory for the Provider to use data centres and disaster recovery centres located in Indonesia. The Provider is also required to meet the minimum standards for IT systems, IT risk management, IT security system resistance and failure, and transfer of IT systems.

Qualifications for employees and management

The Provider must have human resources with IT expertise and have at least one director and one commissioner with experience of at least one year in the financial services industry.

Users and data protection

The Provider must maintain data privacy and protection for users, conduct an audit trail of all lending activities and provide security for IT systems.

Obligatory reporting

A Provider that is registered with the OJK must provide quarterly reports, which include information on users, loans rating and quality and lending activities. Further, a Provider that is licensed by the OJK is required to submit monthly and annual reports to the OJK. The reports must include financial and working performance of the Provider, electronic documents of the lending activities conducted by the Provider and user complaints and actions taken by the Provider to mitigate the issues.

Restrictions

The Provider is prohibited from, among things, conducting any business activities other than P2P lending business activities, acting as a lender or borrower on its lending platforms, providing any guarantees for other parties' liabilities, issuing bonds, providing recommendation to users and providing misleading information.

Sanctions

The OJK may impose administrative sanctions for any breach or failure of the Provider in complying with OJK Regulation 77. Administrative sanctions may be imposed in the form of: (1) warning letters; (2) fines; (3) restrictions on business activities; or (4) revocation of licence.

ii Prudential principles in offshore loan activities

In less than 10 years since 2014, the number of private sector offshore loans increased almost threefold from US$54.3 billion at the end of 2005 to US$159.3 billion at the end of September 2014. Private sector offshore loans reached 54.5 per cent of total offshore loans in

Indonesia.[8] Therefore, on 29 December 2014, the Indonesian central bank, Bank Indonesia (BI), issued BI Regulation No. 16/21/PBI/2014 on the Implementation of Prudential Principles in Managing Foreign Debt of Non-Bank Corporations (BI Regulation 16). This regulation was enacted to govern the prudential principles that must be implemented by non-bank corporations to mitigate risks that may arise from private offshore loan activities, particularly currency risk, liquidity risk and overleverage risk.

Pursuant to this regulation, non-bank corporations with foreign debts in foreign currency must implement prudential principles by fulfilling requirements on certain values of hedging ratios, liquidity ratios and minimum credit ratings.

Recently, an amendment to BI Regulation 16 was issued by BI through BI Regulation No. 18/4/PBI/2016 dated 22 April 2016 (BI Regulation 18).

Under BI Regulation 18, multi-finance companies may now conduct offshore loan activities without being subject to the credit rating requirement as previously required under BI Regulation 16. The exemption is given as long as certain requirements on the level of financial soundness and gearing ratio are fulfilled. Indonesia Eximbank (*Lembaga Pembiayaan Ekspor Indonesia*, or LPEI) has been exempted from this credit rating requirement owing to government policy in supporting export activities in Indonesia.

The key provisions of BI Regulation 16 as amended by BI Regulation 18 are highlighted below.

Hedging ratios

Non-bank corporations with offshore loans in foreign currency are obliged to have a minimum hedging ratio of 25 per cent of the negative balance between Foreign Currency Assets and Foreign Currency Liabilities with: (1) a maturity period up to three months; and (2) a maturity period of between three and six months from the end of the quarter.

Under BI Regulation 16, as of 1 January 2017, any hedging transactions must be undertaken with banks in Indonesia to fulfil the regulatory requirement. Hedging transactions can be conducted through derivative transactions in the form of forward, swap or option transactions. Any hedging transactions not undertaken with banks in Indonesia will not be considered as fulfilment of the hedging ratio requirements, and the receivables derived from the transactions will not be considered as foreign currency assets.

Foreign Currency Assets as defined under the regulation include cash, demand deposits, savings accounts, term deposits, accounts receivables, inventories, marketable securities and receivables originating from forward, swap and option transactions. Foreign Currency Liabilities include all foreign currency liabilities to residents and non-residents, including those originating from forward, swap and option transactions.[9]

8 Bank Indonesia press release dated 30 October 2014, 'Bank Indonesia requires Corporate Borrowers of External Debt to enhance Risk Management', www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_168014.aspx.

9 BI Circular Letter No. 16/24/DKEM dated 30 December 2014 concerning the Implementation of Prudential Principles in Managing Foreign Debt of Non-Bank Corporation.

Liquidity ratios

A minimum liquidity ratio requirement of at least 70 per cent is applied to non-bank corporations with offshore loans in foreign currency. The fulfilment of the minimum liquidity ratio requirement shall be conducted by maintaining foreign currency assets against foreign currency liabilities that will be due within three months of the end of the quarter.

Credit rating requirement

Non-bank corporations with offshore loans in foreign currency are required to have a minimum credit rating of BB– or equivalent, issued by a rating agency that is recognised and authorised by BI. Authorised rating agencies under the regulation include Moody's Investors Service, Standard & Poor's, Fitch Ratings and PT Pemeringkat Efek Indonesia (PEFINDO).[10]

This credit rating requirement is exempted for: (1) offshore loans in the form of refinancing, provided the refinancing does not increase its principal amount; (2) offshore loans to fund infrastructure projects sourced from bilateral/multilateral international institutions; (3) offshore loans to fund central and local government infrastructure projects; (4) offshore loans guaranteed by bilateral/multilateral international institutions; and (5) offshore loans in the form of trade credit. The bilateral/multilateral institutions recognised under the regulation include the International Finance Corporation, the Japan International Cooperation Agency, the Asian Development Bank, the United States Agency for International Development, the European Bank for Reconstruction and Development and UK Export Finance.

Under BI Regulation 18, the credit rating requirement exemption is expanded to offshore loan activities conducted by multi-finance companies and Indonesia Eximbank.

A non-bank corporation may use corporate credit rating (issuer rating) or debt securities credit rating (issue rating) pursuant of the type and maturity of the loan. The validity period of the credit rating should be no more than two years since its issuance.

Reporting obligation

BI requires non-bank corporations to report regularly on foreign exchange activities, including plans and realisations of offshore loans, and on the implementation of prudential principles. Foreign exchange reports must be submitted to BI monthly while the implementation of prudential principles reports must be delivered quarterly.[11]

Sanctions

Non-bank corporations that violate the obligation to comply with the implementation of prudential principles under BI Regulation 16 shall be liable to administrative sanctions in the form of a written warning by BI. BI will also provide information on administrative sanctions to related parties, including: (1) relevant creditors abroad; (2) the Ministry of State-Owned

10 BI Circular Letter No. 18/6/DKEM dated 22 April 2016 on Second Amendment of BI Circular Letter No. 16/24/DKEM.

11 BI Regulation No. 16/22/PBI/2014 dated 3 December 2014 concerning the Reporting of Foreign Exchange Activities and Prudential Principles Implementation Activities in Managing Foreign Debt of Non-Bank Corporations.

Enterprises (SOE) in the case of SOE corporations; (3) the Directorate General of Taxation of the Ministry of Finance; (4) the OJK; and (5) the Indonesia Stock Exchange (IDX), for publicly listed corporations.[12]

Furthermore, non-bank corporations that are incompliant with the reporting obligation will be subject to administrative sanctions in the form of fines.[13]

III TAX CONSIDERATIONS

i Withholding tax

Withholding tax is applicable to domestic or foreign lenders for the interest payable on the principal loan. Under the Income Tax Law, any income received by domestic or foreign taxpayers will be subject to withholding tax, including interest incurred from loans, which includes premiums, discounts and compensation for loan repayment guarantees.[14]

A foreign individual or a foreign entity not domiciled in Indonesia but which receives or accrues income from Indonesia will be considered as a foreign or non-resident taxpayer under the Income Tax Law. Interest payments made to a foreign lender, either a foreign individual or entity, will be subject to a 20 per cent withholding tax.

If a foreign lender resides in a jurisdiction that has a tax treaty with Indonesia, the withholding tax rate may be reduced or eliminated under the provisions of the tax treaty. Indonesia has tax treaties with 65 countries, including Australia, Austria, Belgium, Canada, China, Denmark, Egypt, Finland, France, Germany, Hong Kong, India, Italy, Japan, North Korea, South Korea, Luxembourg, the Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Switzerland, Taiwan, the United Arab Emirates, the United Kingdom and the United States.

ii Registration fees, notary fees and stamp duty

Registration and notary fees for security over land (mortgages) and fiduciary securities are normally applied based on the value of the secured amount.

Particular to fiduciary transfers, a government regulation imposes a limitation on notary fees for preparing a deed of fiduciary transfers.[15] The notary fees are capped as follows:

a a maximum 2.5 per cent of security values up to 100 million rupiah;
b a maximum 1.5 per cent of security values between 100 million and 1 billion rupiah;
c a maximum 1 per cent of security values above 1 billion rupiah, although the fee can be determined as agreed between the notary and the relevant party.

For documentary taxes, any agreement signed by the parties with a transaction value above 1 million rupiah are subject to a stamp duty of 6,000 rupiah.

12 Article 12, BI Regulation 16.

13 BI Regulation No. 16/22/PBI/2014.

14 Law Number 7 of 1983 concerning Income Tax as lastly amended by Law No. 36 of 2008 on the Fourth Amendment of Law No. 7 of 1983.

15 Government Regulation No. 21 of 2015 dated 6 April 2015 on the Procedures for Registering Fiduciary Security Rights and the Fees for Preparing Fiduciary Transfer Deeds.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

The most common forms of security under Indonesian law are described below.

Real estate (land)

Security rights over land (*Hak Tanggungan*) may also be understood as mortgage in other jurisdictions. Security rights over land is commonly taken to secure land with land titles and all fixtures attached to it for the purpose of securing the repayment of loans.

Security rights over land is a security right governed by Law No. 4 of 1996 on Security Rights Over Land Including Objects Related to the Land (Law 4). Under Law 4, security rights over land will not entitle the security rights holder to ownership of the land title upon the borrower's default. The law, however, grants the security rights holder the right with executorial force to sell the land when the borrower is in default, either privately or through public auction, to satisfy loan repayments from proceeds of the sale. The security rights holder will be entitled to the preferential right for the debt settlement over the other creditors.

A deed of grant of security rights over land must be drawn up by and signed before the land deed officer (*Pejabat Pembuat Akta Tanah*) of the jurisdiction where the secured land is located. The deed must be drawn up in the official Indonesian language, Bahasa Indonesia, and in the form provided by the land deed officer. Subsequently, the deed of grant of security rights over land must be registered at the relevant land registration office (*Kantor Pertanahan*) of the National Land Agency (*Badan Pertanahan Nasional*). The security rights over land is effective on the date of registration in the land register maintained by the relevant land registration office. Upon registration of the security rights, the land registration office will issue a certificate of security rights over land to the security holder.

Fiduciary security

Fiduciary security is the common form of security over moveable assets, either tangible or intangible, and certain immoveable assets such as buildings which cannot be the subject of security rights over land under Law 4. Moveable assets that can be taken as fiduciary security include machinery, raw materials, inventory, and vehicles. Receivables can also be taken as fiduciary security.

Fiduciary security is governed under Law No. 42 of 1999 on Fiduciary Transfer (Law 42). As with security rights over land, fiduciary security grants the fiduciary security holder the right with executorial force to sell the secured assets, either privately or through public auction, when the borrower is in default. The fiduciary security holder is also entitled to the preferential right to debt settlement over other creditors.

A deed of fiduciary transfer agreement must be drawn up by and signed before a notary. This fiduciary deed must be in Bahasa Indonesia and is to be the underlying agreement between the lender and the borrower. Under this deed, the borrower (transferor) transfers the legal title over the secured assets to the lender (transferee) for so long as the debt remains outstanding. The fiduciary deed must be registered at the relevant fiduciary registration office. The fiduciary deed is perfected on the date of registration in the fiduciary register maintained by the fiduciary registration office. Upon registration, the fiduciary registration office will issue a certificate of fiduciary security to the security holder.

Pledge

A pledge is a form of security that can only be taken over moveable assets, either tangible assets (such as machinery, equipment and vehicles) or intangible assets (such as shares, account receivables, bonds, debentures, and patent rights), to secure a specified loan.

Pledge security is governed under Articles 1150 to 1160 of the Indonesian Civil Code (ICC). Under the ICC, a pledge must be made by agreement between the debtor or the borrower (pledgor) and the creditor or the lender (pledgee). Indonesian law does not require the pledge agreement to be made as a notarial deed or as a private agreement. However, in practice, pledge agreements are normally made in the form of notarial deeds for the purpose of evidencing in court. In addition, pledge agreements may be attached with a power of attorney to sell the pledged assets, providing the pledgee to sell the pledged assets privately without using a public auction mechanism.

Pledges entitle the pledgee to the preferential right over other creditors to satisfy loan repayments from proceeds of the sale of the pledged assets. The perfection of pledge security may be different depending on the form of the pledged assets. The establishment of a pledge can be described as follows.

a A pledge over tangible moveable assets, such as machinery, equipment or vehicles, will be effective on the deliverance of the goods to the pledgee. The pledged assets must be in the possession of the pledgee.

b A pledge over intangible moveable assets, such as receivables, will be perfected upon the notification of the pledge to the concerned party, by which the right of pledge will be enforced against the concerned party.

c A pledge over shares will be effective upon the notification and recording of the pledge in the share register of the relevant company. If the shares are in certificated form, the original certificate of shares must be delivered to the pledgee. For shares listed on the IDX, the pledge can be established upon the notification of the pledged shares to the company and the recording of the shares by the Stock Administration Bureau (*Biro Administrasi Efek*) appointed by the company in the company's share register. If the shares are listed in scriptless form, the pledgor must also notify the Indonesian Central Securities Depository (*PT Kustodian Sentral Efek Indonesia*), and it will certify the pledged shares.

Hypothec

By the enactment of Law 42, land can only be taken as security under security rights over land, and not under hypothec. Hypothec is a form of security that can be taken over immoveable assets that cannot be secured by security rights over land. Hypothec can be taken to secure the borrower's assets in the form of vessels and aircraft. Further, the ICC stipulates that only vessels with a gross weight of 20 cubic metres or more can be encumbered by hypothec. Vessels below this weight may be taken as security under fiduciary security or a pledge.

In general, hypothec is regulated under ICC Articles 1162 to 1232. Under the ICC, hypothec must be made by a deed of hypothec agreement between the creditor and the borrower, and the deed must be registered in the public registry.

Indonesia currently has no unified, specific regulation on shipping or aircraft hypothec. In relation to shipping hypothec, Indonesia's shipping industry is of the view that the lack of a comprehensive law on shipping hypothec raises challenges to realising Indonesia's aim to be a leading country in the maritime industry. Government action is, therefore, sought and urgently needed to improve the regulatory framework, particularly in financing Indonesia's shipping industry.

ii Guarantees and other forms of credit support

Guarantees

Guarantees are commonly used under the Indonesian jurisdiction. Based on ICC Article 1820, a third party (either a personal or corporate guarantor) may guarantee the fulfilment of the borrower's debt to the lender by the consent of such guarantor. A guarantee can be established by a written agreement made by the guarantor and the beneficiary, either in the form of a notarial deed or a private agreement. Indonesian law does not require that the guarantee agreement must be registered for it to be perfected.

It is important to note that the legal capacity to act as a guarantor is subject to the guarantor's incorporation documents (if the guarantor is in the form of a corporation or PT). The guarantor must be permitted by its incorporation documents to act as a guarantor for the other party's (borrower's) debts. The guarantor must also obtain relevant internal approval, if any, as governed under its incorporation documents.

The lenders are, therefore, recommended to check if the requirements mentioned above are satisfied under the relevant incorporation documents. If the requirements are not met, the guarantor would be considered as having no legal capacity to act as a guarantor, and, therefore, the guarantee cannot be enforced against such a guarantor. In this case, the director of the company who acted and conducted the execution of the guarantee agreement on behalf of the company without complying with its incorporation documents would be held personally liable for the guarantee.

Other forms of credit support

Forms of credit support such as quasi-security structures are not common in Indonesia. With respect to enhancing a creditor's protection against a debtor, the parties may enter into any agreements that can bring benefits to supporting the loan transactions, such as indemnity, performance bonds, bank guarantee, standby letter of credit or negative pledge undertakings as a clause in an agreement. Based on ICC Article 1338 stipulating the principle of freedom of contract, parties having legal capacity may enter into an agreement, and such an agreement will apply to the parties as statute (provided that the contract has no illegal purpose or duress). However, the execution of certain agreements as a form of credit support will not be recognised as security rights under Indonesian law, and will only bind the parties as contractual obligations and will not grant preferential rights to debt settlement over other creditors as a security right.

iii Priorities and subordination

Priorities of creditors

Under the ICC, creditors who hold security rights will have a higher rank and are entitled to preferential rights over unsecured creditors. Therefore, creditors who hold security rights over land, fiduciary security, hypothec or pledge will have the highest rank, unless privileged rights are attached to the secured assets, such as unpaid taxes attached to the assets, court charges resulting from the disposal of the assets or legal charges caused by the sale and saving of the assets. Proceeds from the sale of the secured assets must be made available firstly to the party which holds privileged rights, then the remainder shall be made to the secured creditors.

Priorities of competing security interests

Under Indonesian law, the priority of competing security interests will be determined by the time of registration of the security with the relevant public registry or relevant authorities. The first lender to register security rights over the secured assets will hold first priority to the security, and the second lender to register the security rights over the competing secured assets will hold second priority to the security. On enforcement of the security, the lender who holds the first priority will have a preferential right to receive the proceeds of the sale of the secured assets. The remaining proceeds of the sale will be given to the lender holding the second priority ranking.

This priority ranking of competing security interests is only applicable to security over land and hypothec as permissible under the ICC. Other forms of security, such as fiduciary security and pledge, are not applicable for any ranking, as the security asset cannot be granted to more than one holder.

Subordination of debts

Subordination of debts within lenders is possible to be conducted in Indonesia through contractual arrangements. This can be effected through inter-creditor agreements between the lenders and, if required, the borrower. This agreement may set out priority ranking among the lenders over the secured assets.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Validity and enforceability of lending and securities

Validity of transactions

It should be noted that in doing transactions in Indonesia, the Indonesian Company Law and the articles of incorporation of an Indonesian company normally stipulate certain requirements to obtain corporate approval from the company organs, such as shareholders or the board of commissioners.

Under the Company Law, the board of directors must obtain shareholder approval to encumber the company assets having a value of more than 50 per cent of net assets in one transaction or more, either related or not to each other. The absence of corporate approvals, when it is required, would legally affect the validity of the transaction documents including, in this context, loan agreements, security or guarantee agreements, and they might then become unenforceable. This will cause the directors to be held personally liable for any loss in relation to such provision of the agreement or guarantee/security.

Therefore, it is important for the lenders to take into account the provisions of incorporation documents to make sure any requirement of corporate approvals are satisfied, so the security or guarantee securing the loans would be valid and enforceable. In practice, the lenders would typically require the borrower to provide written confirmation on the fulfilment of such internal corporate requirements.

Enforcement of securities

In the case of a default, securities that grant executorial rights to the security holder can be enforced without a court judgment or court order. However, in practice, for legal certainty in the security enforcement and to avoid any challenges from other parties, a court order would be necessary.

The sale of security assets can be made through public auction. However, a private sale would be permitted in the case that the private sale would generate a higher sale price for the creditor and the owner of the assets has consented to the private sale.

In bankruptcy proceedings, the creditors may enforce security rights against the secured assets as if there were no bankruptcy. In the case of insolvency, the lender is given time to enforce security within two months of the time the borrower is declared insolvent. If the security is not enforced after two months, the curator/receiver of bankruptcy will take over the enforcement of the security.

Financial assistance

In the Indonesian jurisdiction, no prohibitions or restrictions exist on conducting lending arrangements, in particular to provide financial assistance by guarantee or security to secure the loan of a party in connection with the purchase of its shares, its subsidiary or affiliate shares, provided that it is conducted within the law and the articles of incorporation. It must also be conducted with respect to the *ultra vires* doctrine, whereby the action must be conducted within the purposes and objectives of the company and in the interests of the company. The director's fiduciary duty must also be taken into account by ensuring that all necessary corporate approvals are obtained to enable the director to conduct the transactions.

ii Legal opinions practice

In loan transactions in Indonesia, legal opinions are typically made to the lenders on the legal capacity of the borrower and the validity and enforceability of transaction documents and security interests. The legal opinions are normally addressed and made available only to the lenders, and the disclosure of the opinion is typically limited to the counsel and the lenders.

iii Choice of foreign governing law

Choice of foreign law as the governing law is recognised by Indonesian courts as a valid choice of law in an agreement. In financing agreements, choice of foreign governing law is not permitted for securities or guarantee agreements. These agreements must be governed by Indonesian law in order that they are able to be enforced by Indonesian courts.

Foreign judgments cannot be enforced by Indonesian courts on the basis of territorial sovereignty under the Indonesian Code of Civil Procedure. To be enforced in Indonesia, cases with a foreign judgment must be re-examined at the relevant Indonesian court. The foreign judgments may be treated as evidentiary documents; however, Indonesian courts will not be bound by the findings of the foreign court in the foreign judgments.

VI LOAN TRADING

Loan trading is commonly effected in Indonesia by an assignment, which under Indonesian law is recognised as *cessie*. The assignment can be perfected by the acknowledgement of the debtor on the assignment, therefore, binding the debtor to fulfil its obligation to the new creditor who receives the assignment (assignee). The absence of debtor acknowledgement on the assignment will not affect the debtor's obligation to perform its loan repayment to the first creditor, although the assignment agreement has been executed. The debtor is entitled to choose to continue performing its obligation to the first creditor.

The assignment of debt which is secured by security interests, such as security rights over land, fiduciary security or pledges, will include its security to be assigned together with the secured debt. The assignee of the debt would benefit from receiving security rights along with the debt. For the perfection of the security rights, the assignee must notify and register the debt assignment and its security rights with the relevant public registry.

VII OUTLOOK AND CONCLUSIONS

The government of Indonesia is prioritising infrastructure development in Indonesia, but so far it has been dependent merely on the state budget and state-owned enterprises to deliver the projects. This is more than likely to change in the near future, as the government has made efforts by introducing regulatory reforms to establish a more attractive and conducive atmosphere in the coming years for international agencies and private sector finance participants in infrastructure.

Chapter 13

IRELAND

John Breslin and David Burke[1]

I OVERVIEW

The corporate lending market in Ireland continues to be particularly active in the real estate (investment and development), pharma and technological sectors – all of these being significant drivers of the Irish economy. Much of the lending in terms of volume tends to be to the small to medium-sized enterprise (SME) sector.

Currently market conditions are positive, albeit that the decision of the United Kingdom to leave the European Union (Brexit) has created a great deal of uncertainty in the economy. As with a number of other EU Member States, there is an oversupply of credit to meet available demand. In addition to banks, there are a number of venture capital and private equity credit providers. There are also a number of bespoke lenders providing SME finance in the property development sector. The recently enhanced competition in the Irish lending market has contributed to a 'covenant-lite' environment and somewhat increased bargaining power for borrowers. Therefore, if a credit proposition is favourable, there is a very healthy market for debt finance. However, the challenge at the moment is matching the amount of available credit to sound investment opportunities.

Currently deal activity is most active in the real estate sector. Regulated financial institutions have, since the financial crisis, sold large loan portfolios in response to regulatory requirements to consolidate their balance sheets. This introduced to the Irish debt market a large number of US and UK private equity funds that have since established a very significant presence. There has been, therefore, a good supply of substantial property-based financings (including bank and mezzanine financing of property development groups). There is also a steady flow of aircraft finance work in Ireland, with a number of leading global aircraft leasing firms headquartered in Ireland.

Syndicated lending occurs in Ireland but this tends to be in deals towards the larger end of the spectrum and is the exception rather than the rule. For large financings, structures commonly used involve senior and mezzanine finance models (often with a regulated institution providing senior finance and private equity the mezzanine piece), or fund structures. These include investment companies, and Irish collective asset-management vehicles – a bespoke statutory corporate fund tailor-made for tax-transparent fund strategies.

Loan Market Association (LMA) documentation is commonly used in large to medium-sized transactions. Irish law firms that are players in the commercial loan space are

1 John Breslin is a partner and David Burke is an of counsel at Maples and Calder.

used to adapting the LMA to Irish requirements. Ireland is a common law jurisdiction with a long and close common history with the United Kingdom, and, therefore, the LMA is easily adapted to meet particular Irish law requirements.

Irish and EU banks continue to be the main players in all sectors, but increasingly, alternative finance providers such as private equity houses, fund lending structures and asset managers play an ever more significant role. EU-sourced funding plays a significant role too, in particular the Irish Structural Investment Fund (ISIF), often partnering with other credit providers in projects that are suitable for ISIF's portfolio. There is a limited peer-to-peer and crowdfunding market in Ireland. The Irish government has recently published a consultation paper on the potential regulation of crowdfunding.

Notable recent deals feature the refinancing of the O'Flynn Group out of Blackstone Capital financed by Allied Irish Banks, plc and Avenue Capital. The aircraft finance markets have seen increased use of lessor platforms and securitisations.

Overall trends include increasing competition on the lender side with more alternative lenders entering the market to fund large and medium-sized deals. This is has led to a covenant-lite environment. Real estate still leads the way, in particular, with development deals to provide office space and housing in large urban centres.

II LEGAL AND REGULATORY DEVELOPMENTS

The key legal and regulatory development in the area of secured lending was the coming into effect, in June 2015, of the Companies Act 2014 (CA 2014). This substantially removed from security registration requirements many types of financial asset (such as bank accounts and units in collective investment schemes). This is to reflect the intent of the EU financial collateral regime. However, CA 2014 requires urgent amendment to bring charges over shares in non-Irish companies outside the scope of the registration regime. This issue has now been addressed in amending legislation affecting a number of 'running repairs' to CA 2014. It also changed procedures for registering security introducing (1) a one and two-stage process; and (2) electronic filing. CA 2014 also ironed out some difficulties in predecessor legislation dealing with the whitewash of financial assistance transactions and connected party security.

III TAX CONSIDERATIONS

There is a general trend internationally and in the Irish market in which investors are allocating capital to the origination of loans as an asset class. The structures being utilised in an Irish context typically involve the use of an Irish investment vehicle such as the Irish 'Section 110 company' (that is a company that meets the conditions set out in the Section 110 Taxes Consolidation Act 1997 for the tax treatment therein) and Irish qualifying investor alternative investment fund (QIAIF). The Central Bank of Ireland recently relaxed the rules on loan origination by QIAIFs. The borrowers are typically based in Ireland, Europe and the United States, and investors include EU and US investment firms and sovereign wealth funds.

The key Irish tax considerations that impact loan transactions principally relate to the following.

i Deductibility of interest

Interest payable by an Irish corporate borrower is deductible as a trading expense, as a charge on income or as a deduction against rental income for a property rental business. While there is generally no relief for interest on money used to acquire general investments (apart from certain shares and realty) a deduction is given for interest payable by a Section 110 company provided that, where the interest is profit dependent, it is paid to an Irish-resident lender or is subject to tax in an EU or treaty state or is paid on a quoted Eurobond. Special rules apply to related party debt. Recent changes to the Section 110 company regime have restricted deductibility where a company holds assets that derive their value from Irish land unless they are held as part of a CLO, CMBS/RMBS or loan origination transaction and certain conditions are met.

ii Withholding taxes

Irish-source interest on loans of more than one year is subject to withholding at a rate of 20 per cent unless an exemption applies. Perhaps the most common exemptions in the secured lending context are for payments to the following types of lender: Irish banks and Irish branches of EU-regulated banks, companies resident in an EU or treaty state and Irish Section 110 companies. LMA standard loan documentation includes 'qualifying lender' provisions. The effect of these provisions is that, if withholding tax applies to any interest payments, the borrower does not have to compensate the lender by increasing those payments ('gross up') unless the lender is a 'qualifying lender', as defined, on the date they became a party to the loan agreement. The definition of 'qualifying lender' is drafted to reflect the conditions for the many exemptions from Irish withholding tax in the Irish tax legislation. As a result, the day-one risk of withholding is placed on the lender whereas any change of law risk is taken by the borrower.

iii Stamp duty

There is typically no stamp duty on the making of a loan or on any security for the loan. Stamp duty can apply on the transfer of the loan where it contains certain equity-like features (e.g., convertible into Irish shares), but if the loan is sold in the ordinary course of business of either the vendor or the purchaser, then no stamp duty should apply.

iv Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS)

FATCA and CRS have been implemented in Ireland by regulations. Both require reporting of investors by Irish 'financial institutions' (which generally includes funds and investment vehicles) unless the investors are themselves financial institutions in participating states. In our experience, the impact of FATCA and CRS on the structuring of secured lending transactions has been limited. There are typically mutual obligations to provide information to enable the parties to comply with their FATCA and CRS reporting obligations, if any.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

The following are the principal methods of taking security under Irish law and the types of asset to which they principally relate.

a Mortgage: this is the transfer of the legal interest in the asset subject to the borrower's right to have the legal interest conveyed back when the loan is paid off (the equity of redemption).

A mortgage is most commonly used for real estate, ships and aircraft.

As regards real estate, a prescribed form of security instrument is required to create security over land the title to which is registered in the Property Registration Authority. A mortgage of registered land is referred to in the relevant statutes as a 'legal charge'.

b Charge: this is a proprietary security interest comprising the chargor's agreement that the creditor on a default has the right to appropriate and realise the charged asset to pay off the underlying debt and for any net surplus to be returned to the borrower.

The charge is the most common form of security interest under Irish law because of its flexibility. It is principally used for shares, bank accounts and other receivables, and intellectual property.

c Floating charge: this is a form of charge suitable only for assets being turned over in a business (e.g., stock in trade) that are also intended to be security for a loan. It enables the chargor company to sell the assets without the need for creditor consent and without triggering a default. However, a charge created as a floating charge ranks behind certain preferential creditors under Irish law (e.g., the Revenue Commissioners, employees in respect of salaries and other payments, and local authorities to whom local taxes are owed). Under Irish law, except for statutory floating charges over agricultural produce, it is not possible for an individual or a partnership to create a floating charge.

d Pledge: this is essentially the same as a charge (albeit that there is no such concept in Irish law as a floating pledge).

e Lien: this is the right to retain possession of an asset while the underlying debt remains undischarged but does not normally carry with it the right to sell the asset. A lien can arise as a matter of contract and also by operation of the common law (e.g., a mechanic's or a shipyard's lien to retain the vehicle or vessel until work is paid for).

A 'bankers' lien' is more correctly described as a right of set-off.

f Legal assignment: this is the same as a mortgage. It is commonly used for creating security over receivables. The debtor transfers ownership of the receivable as security for the debt: the creditor gives notice to the third party obliged to pay the receivable. Therefore the third party must pay the receivable to the creditor, at which point the third party discharges its obligations.

g Equitable assignment: this is the same as a charge. Like a legal assignment, it is commonly used for creating security over receivables. In this instance, however, notice of the assignment is not given to the third party obliged to pay the receivable. Therefore it is a weaker security than the legal assignment because the third party could pay the receivable (thereby defeasing the asset) without the knowledge of the creditor. However, it is more popular because it is less disruptive to the debtor's business than a legal assignment. The debtor's customers are not given conflicting instructions as to whom payment of their debt should be directed. It is very commonly used in the context of creating security over bank accounts.

The most common means of taking all-asset security from a company is by way of a debenture, which is essentially a deed that can create all of the different types of security interest over the assets that are relevant to the transaction. Under CA 2014 it is possible for a creditor that can identify at an early stage the precise assets over which it is proposed to receive security to obtain enhanced priority by engaging in the two-stage security registration process. However, this process has not been utilised in practice to the extent originally anticipated. This is probably because secured assets are not identified with sufficient precision early enough to make the process worthwhile.

In spite of CA 2014, there are still some particular issues to do with corporate security that need to be addressed in Irish law. Practitioner treatment of the effect of the Financial Collateral Regulations can differ among Irish commercial lawyers, some of whom take an unduly conservative approach and continue to recommend that the creation of collateral over financial instruments should still be registered under CA 2014, which goes against the spirit of the EU financial collateral regime. A more robust legislative statement would be welcome.

ii Guarantees and other forms of credit support

The principal forms of credit support used in secured lending are guarantees and indemnities. Since the onset of the financial crisis in 2008, personal guarantees by business sponsors are less favourably viewed by lenders. This partly arises from occasionally zealous protection of personal guarantors in the Irish courts. Guarantees and indemnities therefore tend to be given by other companies in the borrower group.

Negative pledges still feature in corporate security, particularly all-asset debentures. Since CA 2014, the practice of including reference to a negative pledge in security registration has fallen away because CA 2014 provides that including a reference to a negative pledge in registered particulars has no statutory effect. Set-off provisions are also standard in most loan or security deals and cash-pooling arrangements within groups are also commonly encountered.

iii Priorities and subordination

Debt subordination is typically effected on a contractual or on a structural basis. A debt subordination or priorities agreement is effective under Irish law for the parties to regulate their rights to receive payments from an obligor. Structural subordination is achieved through creditors advancing credit at different levels of a group structure – normally the senior creditor will feature at the level of principal trading company with junior creditors having claims against a holding company. This means that the junior creditor claim is dependent on the subsidiary discharging the senior debt and declaring a dividend to the holding company. Contractual subordination enjoys statutory recognition under CA 2014.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Ireland enjoys a common law tradition and therefore in general, aside from consumer credit transactions, the principle of freedom of contract prevails. To date, the principal basis upon which Irish courts have intervened is where creditors look to impose direct or indirect impediments to a borrower repaying or refinancing its loan. In general, Irish courts are astute to protect the borrower's equity of redemption. Recent case law has shown that attempts to impede a borrower from repaying a loan (e.g., by invoking 'penalty' default rates) will not be permitted.

CA 2014 has minimised the impact of the *ultra vires* rule for company outsiders. It remains important, however, to show that a transaction is for the benefit of a corporate obligor. This tends to feature where a company is providing security for the obligations of other companies in its group.

CA 2014 provides for prohibitions on financial assistance for the purpose of the acquisition of shares in the obligor company or its holding company. The prohibition is subject to limited exemptions. It is possible for such a transaction to be pre-approved by way of the Summary Approval Procedure under CA 2014 (SAP). The SAP is not available to public limited companies. The SAP is not available either to a subsidiary of a public company for the purpose of the acquisition of shares in the public company. The test for determining whether a transaction amounts to financial assistance has been helpfully narrowed by CA 2014.

CA 2014 also provides for prohibitions on a company providing a loan or security for a loan to a director of the company, a director of certain group companies and persons closely connected to such directors (Connected Party Transactions). CA 2014 provides that the SAP can apply to pre-approve a Connected Party Transaction provided that it can be shown that the company will not be rendered insolvent as a result of the transaction.

Security granted in the onset of insolvency is vulnerable under CA 2014:

a any security that is intended to prefer one creditor over another is voidable by the company or its liquidator if it is entered into within one year of insolvency (or three years where the preferred person is connected to the company);

b a floating charge over a company's assets will be void if it has not been granted in consideration of new lending and has been created within 12 months of the date of insolvency (or three years if the floating charge is granted in favour of a person connected to the company); and

c any transaction that amounts to the improper or fraudulent disposition of property can be set aside in the winding-up of the company. There is no statutory time limit applicable.

Legal opinions practice in Ireland closely mirrors that carried on in the United Kingdom. In Ireland, creditor and debtor counsel can provide opinions in respect of transactions. It is normal, however, for creditor counsel to provide an opinion that the transaction documents create legally binding and valid obligations under local law and for debtor counsel to opine that the transaction is within the capacity of the obligor and has been duly authorised on behalf of the obligor. Such opinions are usually addressed to the creditor.

The Rome I and Rome II Regulations apply in Ireland. An Irish court will uphold parties' choice of law subject to the very limited public policy exceptions provided for in Rome I Regulation. Again, subject to very limited public policy exceptions, a court judgment obtained in another EU or EEA member state can easily be enforced in Ireland. Judgments obtained outside the EU and EEA require to be enforced by way of separate proceedings in Ireland and there are greater restrictions on the enforcement of such judgments. For example, the claimant will have to show (among other things) that the court properly assumed jurisdiction over the defendant and that the judgment does not seek to enforce a revenue debt and is otherwise consistent with Irish public policy.

VI LOAN TRADING

Loan participations can be traded in Ireland. It is common for major corporate and real estate loans to be syndicated, although sub-participations occur also.

The most common methods of loan trading in Ireland are as follows:

a Loan or loan portfolio sale: in the wake of the financial crisis and steps taken by authorised banks to bolster their balance sheets in the light of regulatory capital requirements, there has been a significant amount of loan sale activity – albeit tapering off at the moment. The legal method adopted is an assignment by way of outright transfer of the loans together with an assumption by the transferee of all outstanding obligations.

b Syndication: the syndicated loan market is relatively buoyant in Ireland. Syndication involves syndicate banks entering into the facilities and security documentation through an agent bank.

c Sale of sub-participations: the sale of a sub-participation is either funded (in which case it is a *pro rata* assignment of the right to receive payments of interest or repayment of capital) or unfunded (in which case it also involves an obligation on the sub-participant to fund future advances).

d Novation: novation entails the creation of a new contract between the original lender, the original borrower and a new lender. Novations tend to be rare as they can be expensive and cumbersome to organise.

e Other: other potential methods of transferring obligations include a scheme of transfer pursuant to Part III of the Central Bank Act 1971 and a cross-border merger. A Part III transfer must be approved by the Minister for Finance, but once it is then the entire banking business (together with all loans and underlying security) transfer across to the transferee. Cross-border mergers occasionally occur albeit that the EU cross-border regime envisages the new entity having to carry out all required registrations to ensure it can enforce security: see *Kavanagh v. McLaughlin* [2015] IESC 27.

VII OTHER ISSUES

The tide of regulation continues to flow relentlessly. In particular, one needs to be alert with regard to the following less obvious issues. First, purchasers of loans or loan portfolios from authorised banks must appoint a Central Bank of Ireland (CBI)-authorised credit servicer where the underlying loans are to individuals or SMEs. This is to comply with recent legislation designed to ensure that borrowers who enjoyed regulatory protection continue to enjoy it even where an unregulated entity purchases the loan. Second, a detailed credit reporting regime is due to be activated soon in Ireland. The purpose of this statutory regime is to ensure that the CBI can access a wide range of credit information for statistical purposes. Thirdly, market participants and their advisers are closely following potential developments in the regulation of the non-bank lending sector together with EU moves to provide a uniform regime for SME credit. Finally, as noted above, the Irish government is consulting on the regulation of crowdfunding.

VIII OUTLOOK AND CONCLUSIONS

General economic growth in Ireland looks relatively positive at the time of writing, albeit that concerns arising from the terms for Brexit, together with the implications for the land border with Northern Ireland, mean that one must be cautious about the short to mid-term economic outlook.

Chapter 14

ITALY

Giuseppe Sacchi Lodispoto and Raffaella Riccardi[1]

I OVERVIEW

The Italian loan market continues to show signs of growth and renewed activity; recent reforms have moreover been introduced to facilitate real estate lending and the granting of loans to enterprises.

Banks are still the main players, although recent legislation, designed to relax traditional Italian bank monopoly rules is opening the market to other categories of lenders (see Section II.i, *infra*).

Banks increasingly try to model their financing agreements and individual clauses on Loan Market Association (LMA) standards, and recommend them as a starting point for negotiations. However, strong and sophisticated borrowers will seek to negotiate (to a greater or lesser extent) tailor-made provisions for their financing agreements.

II LEGAL AND REGULATORY DEVELOPMENTS

As a result of the financial crisis and additional detrimental events that have impacted on the financial sector, a number of changes, both legal and regulatory, have come into effect. Loan market participants find themselves dealing with such changes on a regular basis. This section details the developments that have, for a long time, had a strong impact on the Italian loan market and its documentation terms.

i Bank monopoly rules

Traditionally, under Italian law, only banks and financial intermediaries were allowed to lend to the public. Italian courts have tended to interpret the relevant provisions quite strictly and have so, for example, held that even the entering into a single financial transaction might be constructed as lending to the public.

Recently, however, legislation has been passed to open the Italian loan market to other categories of participants, in an effort to make credit more easily available to borrowers. In particular, insurance companies and Italian securitisation companies have been allowed to lend (on certain conditions) to persons other than individuals or micro-enterprises and legislative amendments have been passed to regulate the lending by Italian and EU closed-end investment funds to persons other than consumers.

As regards insurance companies and Italian securitisation companies, current legislation now allows them to lend to persons other than individuals or micro-enterprises provided that:

1 Giuseppe Sacchi Lodispoto is a partner and Raffaella Riccardi is a managing associate at BonelliErede.

a the borrowers have been identified by a bank or a financial intermediary authorised to lend in Italy that: (1) in identifying the borrowers and approving the loan, has followed its general lending procedures and policies, and (2) shall then retain a 'significant economic interest' in the transaction, in accordance with implementing regulations issued by the Bank of Italy (in the case of securitisation companies) or the Italian Insurance Supervisory Authority (in the case of insurance companies);[2] and

b in the case of securitisation companies, the notes issued to fund the financing are destined to qualified investors.

Additional legislation has recently been passed regarding the securitisation of deteriorated receivables (*crediti deteriorati*) transferred by banks and financial intermediaries having their registered offices in Italy, under which Italian securitisation companies are, *inter alia*, allowed (in such context and on certain conditions) to grant loans to their securitised debtors, so as to favour their turnaround and increase recovery prospects.

As regards, instead, closed-end investment funds, recent amendments to the Italian Financial Act have set out framework legislation for the granting of loans to persons other than consumers by:

a Italian closed-end investment funds; and

b EU closed-end investment funds:
- that are authorised by their home regulator to make such loans in their home jurisdiction;
- whose model (including, in particular, rules on investment in the fund) is similar to that of Italian closed-end investment funds authorised to issue loans to persons other than consumers; and
- whose home rules on management and fractioning of risk (including, but not limited to, limits to authorised indebtedness) are equivalent to those applicable to Italian closed-end investment funds authorised to issue loans to persons other than consumers.

These reforms have been well received by the market, although the reform is still too recent to verify its actual impact.

ii Basel III, CRD IV and increased costs

Since the Basel III papers were first published, there has been debate over whether the costs entailed should be paid by the lenders (banks) or by the borrowers. Most lenders wish for the borrowers to cover the costs, and have adjusted their indemnity clauses so that Basel III and CRD IV charges are thus paid by the borrowers. There have, however, been exceptions for certain customers who have stronger credits or are substantial borrowers.

2 In the case of loans by Italian securitisation companies, current Bank of Italy regulations set the 'significant economic interest' at 5 per cent and provide that the same must be retained in one of the manners set out in Article 405 of the Capital Requirement Regulation.

iii Sanctions and anti-corruption laws

As a result of strong enforcement action being taken by sanctions authorities, including strict penalties, lenders are (as in other jurisdictions) requesting contractual assurances from borrowers as to their compliance with anti-corruption legislation and sanctions.

Borrowers may seek to limit the scope of such assurances by referring only to specific regimes (so as not to be forced to cover all regimes applicable, anywhere in the world) or by inserting materiality or knowledge qualifications. In any case, the need for such provisions is now widely acknowledged and accepted by borrowers.

III TAX CONSIDERATIONS

i Withholding taxes on interest

Generally speaking, interest on loans paid by an Italian resident borrower to an Italian resident corporate lender (or to a permanent establishment in Italy of a non-Italian resident lender) are not subject to withholding taxes in Italy. Any interest will form part of the business income of the lender, subject to corporate income tax (IRES, at the current rate of 24 per cent) and – in certain circumstances – to regional tax on productive activities (IRAP, at various rates ranging from 3.9 per cent to 5.9 per cent), plus local surcharges.

On the other hand, interest on loans paid by an Italian borrower to a non-Italian resident lender are subject to a 26 per cent withholding tax (that could be lowered according to applicable tax treaty, if any).

However, pursuant to a recent amendment to the relevant tax provision,[3] interest payments on long-term loans extended by foreign lenders are exempted from withholding taxes. In particular, such an exemption applies, *inter alia*, in the event that the lender is authorised to perform lending activity pursuant to the Italian Banking Act (Legislative Decree No. 385 of 1 September 1993, and it is:

a an EU-resident financial institution;

b entities embodied under Article 2, paragraph 5, numbers from 4) to 23) of EU Directive 2013/36/EU;

c an insurance company constituted and authorised to carry out its activity according to EU law; or

d an institutional investor[4] subject to forms of supervision in its country of establishment.

ii Interest deductibility

As a general rule, interest expenses on loans are deductible up to an amount equal to interest income accrued by the same taxpayer in the same taxable year.

Any excess over the above amount is deductible up to 30 per cent of the gross operating income realised by the main business carried out by the company (EBITDA).

Any excess of interest expenses over the above 30 per cent threshold that remains not deductible in a taxable year may be carried forward and deducted (within the same 30 per cent limit) in the following taxable years.

3 Reference is made to Law Decree No. 91 of 24 June 2014, as converted into law with amendments by Law of 11 August 2014, No. 116.

4 As defined under Article 6 of Decree of 1 April 1996, No. 239.

If, in a fiscal year, there is an excess of the above 30 per cent EBITDA over the net interest expenses, the excess may be carried forward without limitation and may be used to increase the relevant threshold in the following taxable years (Article 96 of the Consolidated Tax Act).

Interest expenses incurred in relation to loans guaranteed by a mortgage granted on a real estate to be rented are outside the scope of the EBITDA limit deduction rule.

iii Stamp duty

Under general Italian tax rules, security agreements and guarantees executed in Italy are subject to registration tax that ranges from a minimum of €200 up to a proportional rate of 0.5 per cent (in the event the guarantee is represented by a mortgage, a further mortgage tax applies at the rate of 2 per cent) calculated on the secured amount.

As a general rule, a loan agreement is subject to registration tax at the fixed rate of €200 (although higher rates ranging up to 3 per cent may become applicable in the event that certain financial undertakings are encompassed in the same agreement).

Stamp duty, on the other hand, applies at the fixed rate of €16 for each four pages.

If the relevant agreements are lawfully executed abroad or by 'exchange of correspondence', registration tax and stamp duty are not due upon signing (according to guidelines rendered by the Italian tax authorities, an agreement is concluded by way of exchange of correspondence when signatures of each party to the agreement are kept in separated documents). In these circumstances, registration tax may become applicable if one of the following occurs in the future:

a a 'case of use' (i.e., the agreement is deposited with a central or local court chancery in connection with an administrative procedure); or

b a case of cross reference to the unregistered agreement in a successive deed, agreement or other document entered into, executed or signed by the same parties thereto and registered in Italy, or in a judicial decision rendered in a judicial proceeding between the same parties.

However, long-term loans satisfying certain requirements[5] can benefit – on an optional basis – from a specific 'substitute tax' regime (Imposta Sostitutiva), which provides for the application of a flat rate tax of 0.25 per cent (to be calculated on the amount of the relevant financing) instead of ordinary indirect taxes otherwise applicable (together: the Excluded Taxes).

In particular, when the Imposta Sostitutiva regime is chosen, the Excluded Taxes would not apply to documents connected to the loan, such as securities and guarantees of any kind granted by whomever and at any time.

5 In this respect, to benefit from the Imposta Sostitutiva regime, the loan – *inter alia* – must be granted by an Italian or EU resident bank. Furthermore, according to a very recent amendment to the relevant provisions (reference is made to Law Decree No. 91 of 24 June 2014, as converted into law with amendments by Law of 11 August 2014, No. 116), the Imposta Sostitutiva regime was also extended to long-term financings granted by (1) Italian securitisation special purpose vehicles; (2) insurance companies constituted and authorised to carry out their activities according to EU law; and (3) collective investment funds constituted in 'white listed' EU and EEA countries.

iv Foreign Account Tax Compliance Act (FATCA)

The intergovernmental agreement between the United States and Italy has been concluded, but the implementing decree has not yet been ratified.

As in the case of representations and undertakings on sanctions and anti-corruption, the insertion of FATCA provisions was initially resisted by Italian borrowers but has now become generally accepted in the Italian law loan market.

IV CREDIT SUPPORT AND SUBORDINATION

i Security: general considerations

Types of security interest

Secured lending transactions typically involve a combination of security interests. Security can be taken over all asset classes and the choice of security interest depends on the nature of the asset and its importance in the context of the security package. Section IV.ii, *infra* and Section IV.iii, *infra* analyse the various types of security interests and personal guarantees available under Italian law.

Form of security documents

Security documents are invariably entered into in writing. In many cases this is a legal requirement; in other cases this is done anyway to prevent the guarantor from raising any questions about the existence of the guarantee.

Certain kinds of security interests (mortgages, special privileges, the new conditional security assignment of property, pledges over quotas in Italian limited liability companies and pledges over intellectual property) must be granted pursuant to a notarial or notarised deed, which must be entered into in the Italian language. Non-notarised security documents may also be entered into in English or in other languages.

Where a security package includes more than one kind of security (e.g., mortgage, plus pledge over shares, plus pledge over accounts), separate security documents will be typically entered into in respect of each kind of security interest.

In addition to the above, in most cases of *in rem* security interests Italian law requires the completion of perfection formalities. These will be analysed on a case-by-case basis in Section IV.ii, *supra*.

Absence of security trustee

Because of continuing legal uncertainty on the recognition, validity and enforceability of structures featuring a security trustee or based on parallel debt, it is generally considered preferable to grant Italian law security interests directly to individual lenders.[6]

6 Recently, legislation has been passed to allow the granting of security in favour of the common representative of the bondholders in the event of secured bond and project bond issuances. The common representative is entitled to exercise, on behalf of the note holders, all the rights and faculties (both substantial and judicial) arising from such security interests. Although these provisions should not be applied beyond the case for which they have been specifically introduced (secured bonds or project bonds issuances), they might conceivably pave the way for future legislation applicable also to loans.

Plurality of security interests over the same asset

It is possible to grant a same security interest in favour of a plurality of creditors.

On the other hand, it is not always possible to grant several security interests over the same asset. In particular:

a this is certainly permissible in the case of mortgages, in which case:
- mortgages will rank in accordance with the timing of their registration on the relevant register; and
- holders of lower-ranking mortgages may commence enforcement proceedings in respect of the mortgaged asset, provided that holders of higher-ranking mortgages would be notified and would be satisfied in priority (subject to intervention in the enforcement proceeding); but

b on the other hand, it is doubtful that several pledges or special privileges may be created over the same asset.

ii Forms of in rem security interest

Security over land and other real estate

Creation and enforcement of security over land and other real estate has been at the centre of recent legislative reforms aimed at making real estate lending (especially on commercial property) more easily accessible. These reforms have consisted: (1) on the one hand, in a general overhaul of Italian enforcement proceedings, designed to increase their efficiency and reduce their duration; and (2) on the other hand, in the introduction (for certain categories of assets) of a new form of conditional security assignment (described in Section IV.ii, 'Conditional security assignment of property', *infra*), which could prove quicker and more efficient to enforce than mortgages.

Mortgages

Mortgages are created upon registration on the relevant Italian land register.

Mortgages have to indicate a maximum secured amount, which must be expressed in euro (even though the underlying obligation may be in a different currency). Typically, this would be higher than the initial principal amount of the secured obligation.

Mortgages entitle the mortgagee to obtain the sale of the mortgaged property through a court-supervised sale proceeding. This has traditionally proved quite lengthy, and it is therefore not unusual (in large mortgage-lending transactions) to set up arrangements for the private sale of the mortgaged assets without resorting to enforcement of the mortgage; as anticipated, it is, however, possible that recent reforms may reduce this issue in the future.

First-ranking mortgages over land or other real estate, securing medium-to-long term loans issued by Italian or EU banks, and having an initial loan-to-value ratio not exceeding 80–100, may benefit from the '*credito fondiario*' regime. This entails several advantages for the lender (e.g., shortened consolidation period, and possibility to continue enforcement pending the debtor's bankruptcy). On the other hand, the borrower benefits from certain enhanced protection and rights (e.g., extended grace periods in the event of payment default).

Conditional security assignment of property

The conditional security assignment: (1) may only secure financings granted to an entrepreneur by a bank or an authorised financial intermediary, and (2) may not relate to the main home of the mortgagor, his or her spouse and certain other categories of his or her close relatives. The security assignment may be in favour of (1) the lender or (2) a corporate entity that is controlled by (or affiliated to) the lender and authorised to purchase, hold, manage and transfer real estate.

The conditional security assignment is perfected through registration in the relevant Italian land register.

The security assignment is conditional upon material default by the borrower on its payment obligations: the law identifies the criteria (i.e., number of unpaid instalments; duration of the delay) to determine when the payment default may be regarded as such. To the extent the security assignment is activated by the lender, the value of the real estate is to be estimated by a valuer appointed by the court; if the valuer finds that the value of the real estate is higher than the lender's credit (plus transfer costs and expenses), the lender is required to pay the difference to the owner of the real estate.

Security over ships and aircraft

Security over ships and aircraft would also be taken by way of a mortgage.

Such mortgages are perfected through registration on the applicable register and annotation on certain documents that are held on the ship or aircraft itself. In the case of ships, this may in practice prove a lengthy process, as it will be necessary to wait until the ship has entered a port where an Italian authority empowered to effect the registration is present.

As in the case of mortgages created on land or buildings, aircraft or shipping mortgages have to indicate a maximum secured amount, expressed in euro.

Aircraft and shipping mortgages present a number of peculiarities because of the nature of the underlying asset. In particular and *inter alia*:

a in practice, it may prove difficult to enforce security over an aircraft's engine, especially if it may not be specifically identified or has become separated from the aircraft;

b certain privileged creditors (e.g., the crew, or port or airport authorities) may be preferred to the mortgagee; and

c seizure or enforcement of mortgages on aircraft that are effectively used on an air transport line or kept in reserve to be used on an air transport line may be subject to special authorisations or limitations.

Security over shares or financial instruments

Security over shares or financial instruments would be taken by way of a pledge. This would, whenever possible, be done pursuant to Legislative Decree 170/2004, which has implemented in Italy EU Directive 2002/47/EC on financial collateral arrangements.

Save where the less rigorous formalities of EU Directive 2002/47/EC on financial collateral arrangements apply, pledges:

a must be granted by way of a written agreement bearing 'date certain' at law; and

b are perfected (depending on the type of financial instrument) by way of registration on the certificate or a register, or in the centralised systems for dematerialised instruments.

Pledges over shares or quotas in companies grant the pledgee the right to exercise voting and other shareholders' rights. However: (1) these are typically waived in favour of the pledgor until an enforcement event should occur, and (2) in practice, even in a default scenario, creditors are typically reluctant to exercise them.

Pledgors and pledgees are, in general, free to agree on the manner in which the pledge is to be enforced, provided they do not simply agree that the pledgee shall be entitled to keep the shares or financial instruments in satisfaction of its claims. As in other EU jurisdictions, in pledges granted pursuant to Directive 2002/47/EC it is required that such procedures be reasonable from a commercial viewpoint.

Security over receivables and insurance policies

Security over receivables may be taken by way of a pledge or a security assignment; generally, the second would be adopted.

The security assignment or pledge is perfected through notification to the assigned debtor (or acceptance by the assigned debtor) with date certain at law. It is, however, not unusual to postpone this latter formality until an enforcement event should occur. Lenders should however note that if, in the meantime, (1) other security assignments or pledges are notified, these will prevail (although entered into at a later date), or (2) the receivables are attached by other creditors (or the assignor or pledgor is declared insolvent) the relevant creditor's or insolvency proceeding's right will prevail.

The assignment or pledging of certain kinds of receivables (e.g., receivables against public administrations) may require additional formalities.

Receivables towards insurance companies insuring mortgaged properties in many cases are not assigned. Rather, a loss payee clause is placed on the insurance, requiring *inter alia* the insurance company to pay any liquidated damages to the mortgagee.

Security over bank accounts

Security over bank accounts would, whenever possible, be construed as a pledge over monies governed by Legislative Decree 170/2004, which has implemented in Italy EU Directive 2002/47/EC on financial collateral arrangements.

When this is not possible, the security is constructed as a pledge over the receivable held by the pledgor in relation to the bank as a consequence of the existence of a cleared credit balance. However, this approach presents several drawbacks, not least of which that perfection of the pledge would need to be renewed each time new monies are credited to the bank account.

Security over tangible moveable property

Security over tangible moveable property has traditionally been taken by way of a pledge or (when admissible) a special privilege. Recent legislation has introduced a third form of security interest (consisting in a non-possessory pledge) to address some of the shortcomings of these two forms of security.

Pledge

Pledges on moveable properties require a written agreement, with date certain at law and (subject to specific exemptions) delivery of the pledged assets to the pledgee (or a custodian). In practice, this latter requirement makes pledges an acceptable form of security for moveable assets of which the pledgor may dispossess itself (e.g., bonds and securities) or for which special laws allow retention by the pledgor, but a difficult security to implement in cases where the pledgor must (or anyway wishes to) retain the availability of the pledged assets (e.g., machinery).

Special privileges

Special privileges may be taken (1) to secure medium-long term loans granted by banks to commercial enterprises, and (2) over certain categories of assets (e.g., machinery, equipment, concessions, raw materials, inventory, goods purchased with the relevant financing, receivables arising from the sale of the above), to the extent destined to the running of the borrower's business. Special privileges may not, however, be taken over registered assets such as ships or aircraft.

The special privilege (and the new non-possessory pledge over moveable assets) are the closest instruments to a floating charge that Italian law recognises as they cover classes of assets owned from time to time by the borrower, as opposed to specific assets owned by the grantor at the time the security is granted. In addition, special privilege does not require delivery of the relevant assets to the pledgee (or a custodian) and is, therefore, (where implementable) an efficient alternative to pledge.

Special privileges are perfected through the filing of the relevant deed, with the competent court of the area where the grantor has its registered office.

Non-possessory pledge

The non-possessory pledge may be granted by entrepreneurs over the enterprise's current and future moveable assets (other than registered moveable assets such as cars, ships and aircraft) and business receivables, as security for financings granted (to the entrepreneur or other parties) for purposes connected with the carrying out of the enterprise's activities.

Non-possessory pledges must be granted in writing and are enforceable upon registration on an electronic register, to be established and kept by the Italian Tax Authority. The non-possessory pledge will have to indicate a maximum secured amount.

Unless otherwise provided in the pledge agreement, the pledgor may transform, transfer (in compliance with their economic destination) or otherwise dispose of the pledged assets; in such cases, the pledge would extend to the asset resulting from the transformation or to the disposal proceeds (or any other assets acquired through such proceeds).

To the extent this is expressly provided in the relevant pledge agreement, enforcement rights may include the right to lease the pledged assets (and allocate lease rentals to the satisfaction of the secured claims).

Security over intellectual property rights

Security over Italian patents, designs, trademark registrations and trademark application has typically been given in the form of a pledge. Delivery of the pledged asset or perfection of security is achieved by registration of the pledge with the competent IP right registry. It is now, however, possible to subject also these assets to the new non-possessory pledge.

iii Forms of personal guarantees

Italian law recognises two main forms of personal guarantees: suretyships and first demand guarantees.

In banking practice, guarantees are typically granted in the form of a first demand guarantee, whereby the guarantor is requested to pay upon simple demand and without being able to raise any pre-emptive objection, as they leave much less scope for exceptions by the guarantor than a suretyship. Courts would, however, grant orders prohibiting the guarantor from paying, where manifest fraud may be shown.

A letter of patronage is sometimes accepted as a substitute to an outright guarantee. The contents of Italian letters of patronage may vary, and their value would depend on the nature, content and strengths of the obligations assumed in each single case by the sponsor.

Italian law requires all forms of personal guarantees to be capped with reference to a maximum guaranteed amount. This could also apply to obligations arising from letters of patronage.

iv Subordination

In banking transactions, subordination generally takes two forms:

a structural subordination (where the order of payment depends on which company in the group is a debtor to the junior and senior creditors); and

b contractual subordination, where the order and ranking of debt is arranged by the creditors (usually through an intercreditor or subordination agreement). While this form of subordination is thought of as being enforceable between contracting parties, it must be noted that the question of the enforceability of a subordination clause in the context of bankruptcy proceedings is untested in Italian courts.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Main legal reservations

Capacity and corporate benefit

Italian companies may grant security for or assume joint liability with other entities to the extent this is justified by a sufficient and proportionate individual corporate interest of the guarantor or joint obligor. The existence of an interest or of advantages for the grantor's group as a whole, or for the grantor's shareholders, will not be sufficient *per se*, unless it may be shown that the individual guarantor or joint obligor also directly or indirectly derived an actual, sufficient and proportionate profit from it.

The existence, nature, sufficiency and proportionality of the corporate benefit must be discussed, analysed and set out in detail in the grantor or joint obligor's board resolution. Legal counsel would typically ensure that this is the case, but would then assume the existence of a sufficient corporate interest in his or her legal opinion.

Downstream guarantees do not usually present particular problems since the benefits to a parent in guaranteeing the obligations of its direct or indirect subsidiary are usually self-evident (although exceptions may exist, for example, if the grantor itself is in difficult economic circumstances).

On the other hand, the corporate benefit is less evident in the case of guarantees in support of a parent or sister company's obligations and will therefore require precise identification and explanation. Accordingly, in group financing transactions where Italian subsidiaries are required to guarantee the indebtedness of their parent or sister companies, it is usual for such guarantees to be capped by reference, for example, to the portion of global financing received through intra-group loans or equity injections, or through the Italian grantor's net worth.

More stringent rules may exist in certain regulated industries in connection with the granting of intra-group guarantees.

Financial assistance

Traditionally, financial assistance (i.e., a target company and its direct or indirect subsidiaries financing their own acquisition or granting guarantees or security in connection with indebtedness assumed to finance or refinance their own acquisition) was subject to a blanket prohibition in Italy.

Recent legal amendments (and implementation of the Second Company Law Directive (Directive 2006/68/EC)) have, however, allowed Italian joint-stock companies to grant financial assistance if, *inter alia*:

- *a* an extraordinary shareholders' meeting approves the transaction in advance, following an enhanced procedure;
- *b* the aggregate amount of all loans and guarantees does not exceed aggregate distributable profits and reserves (as resulting from the most recent approved financial statements); and
- *c* a special purpose non-distributable reserve for an amount equal to the aggregate of all loans and guarantees is registered in the company's financial statements.

However, since this is quite cumbersome and requires the cooperation of the target company's directors and shareholders prior to the acquisition, it is not usual for Italian joint-stock companies to grant guarantees or security in respect of the acquisition financing.

Accordingly, in many cases, borrowers would secure acquisition financing by immediately granting a pledge over the target's shares and would then (and if required) organise:

- *a* a merger with the target company; and
- *b* the refinancing of the acquisition facility (with granting of security over the assets of the company resulting from the merger).

The merger would, however, have to follow the enhanced procedure provided under Article 2501 *bis* of the Italian civil code.

Clawback risks

Guarantees and security provided by an Italian company (or any foreign company subject to Italian insolvency proceedings) may be at risk of being clawed back on the request of the insolvency officer if:

- *a* given within a certain period prior to commencement of liquidation or administration; and
- *b* at the time the security was granted or created, the grantor was already insolvent and the beneficiary had actual or constructive knowledge thereof.

The duration of the vulnerability period differs, depending *inter alia* on whether the security was granted (or promised, as the case may be):

- *a* at the same time as the secured indebtedness was incurred; or rather
- *b* for pre-existing indebtedness.

Special rules may apply to certain kinds of security (e.g., and most notably, mortgages granted in the context of a mortgage loan transaction carried out under Article 38 et seq. of Legislative Decree 385/1993 (the Italian Banking Act) (*credito fondiario*) would consolidate in 10 days).

The burden of proving that the grantor was already insolvent and the beneficiary had (or did not have, as the case may be) actual or constructive knowledge of the insolvency would shift between the grantor and the insolvency official, depending on the circumstances in which the security was granted.

Security duly granted under restructuring agreements governed by Article 67 and Article 182 *bis* of the Italian bankruptcy law are generally exempted from the risk of clawback.

Italian legislation on usury and compounding of interest

Italian legislation:

a prohibits lenders from lending at all-in interest rates that are higher by more than a certain amount than the ones published (for each kind of transaction) on a quarterly basis by the Italian Treasury. It is debated whether it sufficient for the contractual interest rate to be lower than the maximum interest rate admitted by Italian usury legislation on the date the credit agreement is entered into or whether it is required that the contractual interest rate at no time exceed the maximum interest rate admitted from time to time by Italian usury legislation. Most credit agreements now adopt the second approach and cap contractual interest rates at the maximum level admitted from time to time by Italian usury law; and

b limits lenders' ability to compound or capitalise accrued but unpaid interest.

It is common practice for Italian law legal opinions to contain qualifications relating to legislation on usury or compounding of interest.

Security trustee and parallel debt

To the extent a security trustee or a parallel debt structure is adopted in respect of Italian law security, in most cases Italian law legal opinions will be qualified by stating that no opinion be expressed as to matters relating to the recognition, validity or enforceability of any such trust or parallel debt structure.

ii Legal opinions practice

Where legal opinions are concerned, their content and method of delivery in Italian law secured lending transactions is well established.

Before funding, lenders require opinions on (1) each borrower's and guarantor's capacity and authority, and (2) the validity and enforceability of the facility documentation (including any security documents) and the enforceability of security interests.

The general expectation is that counsel to the borrower will deliver the former and counsel to the lenders will deliver the latter.

VI LOAN TRADING

Italian law theoretically admits both:

a the assignment of receivables arising from a drawn credit facility, subject to such limitations as the parties may have agreed in the finance documents; and

b the assignment of the whole contractual position, including obligations to effect yet undrawn facilities, subject to borrower consent.

In practice, while the first type of transaction is frequently implemented, the second is practically never adopted.

With respect to the acquisition of receivables arising from secured loans, the following should be noted:

a the purchaser of the receivables should, as a general rule, be an entity authorised to conduct banking or financial activities in Italy, an Italian securitisation company or an authorised fund; and

b generally speaking, security would be transferred automatically together with the receivables. However, depending on the type of security, specific formalities may be required to make the transfer effective (e.g., annotation on land registries, giving of notices, etc.), which (depending on the characteristics of the security and the loan) might trigger stamp duty and other indirect taxes. As stated in Section IV, *supra*, Italian lending transactions do not normally feature a security trustee, which makes this issue particularly relevant.

VII OUTLOOK AND CONCLUSIONS

The Italian government is committed to facilitating foreign investment in Italy, increasing access to credit for Italian enterprises and making it easier for banks to unload non-performing loans currently present on their balance sheets. This has led, and is leading, to a number of important reforms, which may have a profound impact on the Italian lending market.

Some of these reforms (e.g., provisions to relax the Italian bank monopoly rules, amendment to withholding tax rules, the possibility for common representatives to hold security on behalf of the holders of secured or project bonds, introduction of new forms of security interests and the general overhaul of Italian enforcement proceedings) have been touched upon in this chapter. Others have already been enacted (e.g., a reform of lease agreements, which is already facilitating the real estate credit market) or have been announced.

Foreign investors would seem to have taken notice and deals have been recently announced and carried out that have seen major international players step up their investments in Italy.

It will be interesting to see how these trends develop in the coming months.

Chapter 15

JAPAN

Kenichi Yamamoto, Taro Awataguchi, Kei Sasaki and Wataru Higuchi[1]

I OVERVIEW

Japan has seen a significant spike in the volume of transactions involving loan lending, such as asset acquisition finance. This is due in part to the aggressive economic stimulus policy instituted by Japanese Prime Minister Shinzo Abe, coupled with the weakening of the yen. The Japanese economy has also been boosted since Tokyo's successful bid for the 2020 Olympic and Paralympic Games, which are projected to generate economic activity of around ¥3 trillion. As a result, there has been a positive mood of inflation in Japan, which has in turn led to an increase in the prices of stocks and real estate.

In addition, project finance continues to grow, and is recognised as an expanding field of finance in Japan. The enactment of the Renewable Energy Act in 2012 introduced a feed-in-tariff scheme, which created a large project finance market in renewable energy projects in Japan. Indeed, to date a significant number of mega solar power plants have been financed through such project finance schemes.

II LEGAL AND REGULATORY DEVELOPMENTS

i Reform of regulation on money lending business

Under Japanese law, a lender who provides a loan to a Japanese borrower must register as a money lending business operator (MLB Operator) with the Financial Services Agency of Japan (FSA) or a local government in Japan as applicable under the Money Lending Business Act of Japan (Act No. 32 of 1983, as amended; the MLB Act), unless:

a the lender holds a bank business licence under the Bank Act of Japan (Act No. 59 of 1981, as amended; the Bank Act) or any other licence or permissions under the special laws that allow the lender to provide a loan; or

b the lender has been established under certain special laws.

To register as the MLB Operator, the lender must first fulfil certain requirements including the maintenance of certain net assets and hiring a money lending business manager who has passed certain examinations under the MLB Act.

1 Kenichi Yamamoto, Taro Awataguchi, Kei Sasaki and Wataru Higuchi are partners at Anderson Mōri & Tomotsune.

On 1 April 2014, certain exceptions were established by the reform of the Order for Enforcement of the Money Lending Business Act (Ordinance No. 181 of 1983, as amended) with regard to this regulation on money lending business. Under the amended order, the lender may provide a loan without the registration as the MLB Operator in the case where:

a the borrower is a company that has certain capital relationships with the lender; or

b the lender is a shareholder of a borrower that is a joint venture company (JV Co), where 20 per cent or more equity of which is held by the lender, and the lender's loan has been consented to by other holders of the equity in the JV Co.

After the reform, it has been clarified that a foreign lender who is a JV investor in a Japanese company and holds 20 per cent or more equity in the JV Co may also give financial support in the form of a loan without the registration as the MLB Operator in Japan.

ii Basel III

Japanese banks and other financial institutions that have one or more business addresses abroad (including foreign branches or foreign companies) are subject to Basel III under the Bank Act or other applicable acts for these financial institutions. As agreed internationally, Basel III is gradually applicable to those financial institutions.

On the other hand, other Japanese local banks without any foreign business addresses are not subject to Basel III under Japanese law. However, the FSA, the Japanese financial regulatory authority, issued a notification that applies to local banks as of 8 March 2013 and amended it several times. The notification is a kind of localised Basel III, and requires that core assets must be 4 per cent or more of its risk assets. This is a concept similar to, but different from, Tier 1 capital under Basel III. In this regard, it should be noted that it is not often the case that loan documents contain Basel III-related terms and conditions.

iii Other regulatory updates

As mentioned in Section VII, below, a bill to reform the law of obligations under the Civil Code and relevant reform has passed the Diet of Japan. If the reform is enacted, a statutory default interest rate will be changed from 6 per cent for commercial transaction to a floating rate. However, such default interest rate is not used in loan transactions, and a borrower and a lender agree certain interest rates on a deal-by-deal basis, so the impact of the reform to the Civil Code will be limited.

Except for items mentioned above, there are no significant regulatory updates that have significant impact on loan markets or loan providers. Further, no specific and material amendments or updates to anti-corruption regimes have been found in recent years.

III TAX CONSIDERATIONS

i Assumption

The explanation provided in this section is limited to the scope of loan transactions between corporations (i.e., non-individuals). Further, our explanation is based on Japanese laws and tax conventions effective as of 1 May 2017.

ii Income tax on the lender

Corporate income tax on a Japanese corporation and a foreign corporation with PE

Certain interest paid by a borrower of Japanese corporation or foreign corporation that has a permanent establishment in Japan (the Japanese borrower) constitutes a taxable income for the Japanese lender under the Corporation Tax Act of Japan (Act No. 34 of 1965, as amended). The effective tax rate applicable to a corporation in Tokyo earning a taxable income of ¥8 million or over is currently 30.86 per cent for the tax year from 1 April 2017 to 31 March 2018.

Interest paid by the Japanese borrower to the Japanese lender is not subject to withholding tax.

Income tax on the lender who is the non-Japanese lender

Interest paid by the Japanese borrower to the non-Japanese lender falls within domestic source income that is subject to income tax in Japan. The interest is subject to 20 per cent withholding tax under the Income Tax Act of Japan (Act No. 33, 1965, as amended). However, in the case where the non-Japanese lender may enjoy benefit under certain tax treaty to which Japan is a party, the withholding tax is exempted or certain reduced withholding tax rate is applicable.

iii Tax on the Japanese borrower

Loan principal received by the Japanese borrower is not taxable in Japan.

In principle, interest paid by the Japanese borrower may be deducted from the taxable profit of the Japanese borrower for the purposes of Japanese corporation income tax. However, deduction of certain interest paid to the non-Japanese lender that has close relationship with the Japanese borrower is limited under special rules such as the transfer pricing tax regime, thin capitalisation and the earnings stripping rule under Japanese tax law. The outline of the special rules is provided in the following subsections.

Transfer pricing

The transfer pricing tax regime is a policy that prohibits control of prices for cross-border transactions between related companies, which results in reducing taxable income in Japan. If interest paid to a 'foreign related party', which is a party: (1) who has directly or indirectly 50 per cent or more of capital contribution in the Japanese borrower; or (2) who can make substantial decisions in relation to all or part of the Japanese borrower's business is beyond arm's-length interest rate (or paid under preferred terms), the loan transaction is deemed as being made at arm's-length terms and excess interest paid to the foreign related party cannot be deducted from the taxable profit of the Japanese borrower.

Thin capitalisation rule

The thin capitalisation rule limits cross-border loan transactions to provide financial support for Japanese subsidiaries instead of capital contribution, since interest on the loan principal can be deducted from the taxable income as opposed to cash distribution, which cannot be deducted in principle. This leads to reduction of the tax base in Japan. The basic rule states that in circumstances where interest is paid on liabilities due to a foreign controlling shareholder and its related entities (Foreign Controlling Shareholder) or a lender who provided the capital or guarantee by the foreign controlling shareholder for the loan to the Japanese subsidiaries (Capital Supplier), where the average balance of liabilities due to either a Foreign Controlling

Shareholder or Capital Supplier exceeds three times of the capital in the paying entity held by the Foreign Controlling Shareholder then the amount of interest payable on the excess amount of such liabilities would not be tax-deductible.

Simply put, this exception provides that where a company is not thinly capitalised overall (because it is maintaining a debt-to-equity ratio of less than three to one) it would not be treated as thinly capitalised with respect to a particular foreign controlling shareholder, even if lending from them exceeded three times their equity interest.

Earnings stripping rule

The earnings stripping rule, which has been effective since 1 January 2014, prevents the reduction of taxable income in Japan by paying excessive interest against non-Japanese borrowers. If the net interest payment of the Japanese borrower to the related parties (which is interest paid to the related parties after deduction of interest paid to the Japanese borrower by related parties and which is multiplied by certain rate of interest payment to the related parties against whole interest payment) is beyond 50 per cent of certain adjusted taxable income for a certain tax year, the excess amount of the net interest payment of the Japanese borrower to the related parties cannot be deducted from the taxable income of the Japanese borrower for the tax year.

iv Stamp duty

If an original copy of the loan agreement is signed or sealed in Japan, the parties are subject to stamp duty obligations. The price of the stamp required under the Stamp Duty Act of Japan (Act No. 23 of 1967, as amended) would depend on the loan principal. If the loan principal is ¥100 million, the necessary stamp duty is ¥60,000, and if the loan principal is ¥500 million, a stamp duty of ¥100,000 is required. To save stamp duty cost, practically, parties to loan transactions often prepare only one original copy, and the lender retains the original copy, and the borrower only receives a duplicate copy of the loan agreement.

v Foreign Account Tax Compliance Act (FATCA)

The Japanese government continuously encourages Japanese financial institutions to comply with FATCA. The Japanese government, together with the US government, issued the Statement of Mutual Cooperation and Understanding between the US Department of the Treasury and the Authorities of Japan to Improve International Tax Compliance and to Facilitate Implementation of FATCA on 11 June 2013, and issued an additional statement on 18 December 2013 modifying the original statement. Based on these statements, the FSA and some other Japanese administrative departments have requested Japanese financial institutions (including banks and securities firms) to register with the Internal Revenue Service in the United States as a foreign financial institution and comply with FATCA. Based on this framework, Japanese financial institutions, in principle, are exempted from withholding obligations under FATCA.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Different types of security interests may be created by one security agreement. However, the security interest in each type of asset must be perfected separately. We set out a brief summary of the common methods of taking security over different types of assets in Japan, including how such security interests are typically created, any perfection requirements and the extent of any registration, tax or other costs involved below.

Real property (land)

Under Japanese law, a typical security interest upon real property is a mortgage. For a revolving facility with a maximum claim amount, a revolving mortgage is applicable.

A mortgage on land or a building is created by an agreement between a mortgagor and a mortgagee. To perfect the mortgage against a third party, the mortgage must be registered with the Legal Affairs Bureau (LAB) having jurisdiction over the property. There are approximately 500 LABs throughout Japan.

Under Japanese law, the land and any building on the land are treated independently. Therefore, the mortgagor of the land and the mortgagor of any building on the land could be different entities. It is, therefore, important to separately create and perfect the mortgage as a first lien upon both the land and the building. In Japan, almost all land (by parcel) and buildings (by building, upon completion) are already registered with the LAB. The registration of the mortgage is made as an addition to the existing registration. Therefore, it is necessary to investigate the title and confirm whether the property is already encumbered by an existing mortgage. Typically, a mortgage registration includes:

a the name and address of the debtor and mortgagor;
b the origin and date of the mortgage;
c the priority; and
d the loan amount (in the case of a revolving mortgage, the maximum loan amount).

Though various covenants and other provisions may be included in the mortgage agreement, the full mortgage agreement is not recorded in the registration. The registration fee that has to be incurred to register a mortgage is 0.4 per cent of the loan amount.

Moveable property

Pledge

Moveables may be collateralised by way of a pledge. While there is no transfer of ownership, critical to the creation of a pledge is the physical delivery and possession of the subject matter of the pledge. In other words, to create and perfect a pledge, the pledger must physically deliver the moveables and the pledgee must hold possession of the same, and, thus, the pledger cannot use the pledged assets until the secured claim is satisfied.

Assignment as security

Moveables may be also collateralised by way of assignment as security. This security interest can be created by a security agreement between an assignor and an assignee. To perfect this security interest, the target moveable must be 'delivered' from the assignor to the assignee. Delivery can be made not only by: (1) physical delivery, but also by (2) constructive delivery or (3) registration with the LAB. The security provider (assignor) can continue to possess and use the moveable assets if (2) constructive delivery or (3) registration with the LAB is selected as a means of perfection, and this is the advantage of assignment as security compared to pledge. Assignment as security is typically used to create security over inventories or machinery, which a debtor would usually prefer to retain possession of. It is not certain whether a concept of priority exists for assignment as security, although there is court precedent that would seem to admit the concept of the priority generally.

Receivables

A security interest in receivables (i.e., a claim) may be taken by a pledge or assignment as security. These security interests can be created by a security agreement between the pledger or assignor and pledgee or assignee.

In creating the security interest, it is necessary to identify the target receivable enough to specify it (such as kind, date of origination and other items to the extent applicable). If the target is a claim to be generated in the future (future claim), the period (beginning and end dates) must be specified in the security agreement and in connection with perfection. If there is an agreement made between the debtor and the obligor of the target receivable that prohibits pledge or assignment of the target receivable, the pledge or assignment is basically invalid, with two exceptions:

a if the pledgee or assignee is unaware of the prohibition agreement without gross negligence, the pledge or assignment shall be valid; and

b the pledge or assignment will become valid retroactively from the time of the pledge or assignment (to the extent not harmful to a third party) if the obligor of the target receivable consents to the pledge or assignment, even if there has been a prohibition agreement.

The pledgee or assignee can assert the security interest against the obligor of the target receivable upon:

a notice to the obligor from the pledger or assignor; or

b acknowledgment of the obligor.

The pledgee or assignee can assert the security interest against a third party (such as a double pledgee or assignee or bankruptcy trustee of the pledger or assignor) upon:

a notice to the obligor of the target receivable from the pledger or assignor by a certificate with (a stamp of) a fixed date;

b an acknowledgment of the obligor of the target receivable by a certificate with (a stamp of) a fixed date; or

c a claim pledge or assignment registration with the LAB.

The registration can be made with the LAB upon creation of the security interest without notice to the obligor. In such a case, practically, the notice to the obligor of the target receivable will be sent upon the event of default of the pledger or assignor, and the notice must be accompanied by a registration certificate (this notice can be sent by the pledgee or assignee).

Shares

Shares of companies incorporated under Japanese law can be pledged or assigned as security. Since, in practice, pledges are commonly used rather than assignment as security, we explain the concept of share pledge below. In this regard, the following three types of shares may be pledged, namely shares that are:

a unlisted and with certification;

b unlisted and without certification; and
c listed.

For shares that are unlisted and with certification (physical certificates are issued), a pledge can be created by a security agreement between a pledger and a pledgee followed by physical delivery of the certificates to the pledgee, and perfected against the issuing company and any third party by continuous possession of the certificates by the pledgee. As this type of pledge is unregistered and, thus, unknown to the issuer, any dividend will be paid to the pledgor, and upon an event of default, the pledgee has to seize the dividend before it is paid to the pledgor. In contrast, if the name and address of the pledgee and target shares are registered on the shareholders' list at the request of the pledgor, the dividend can be paid directly to the registered pledgee.

For shares that are unlisted and without certification, a pledge may be created by an agreement between the pledgor and pledgee, and must be perfected against the issuer and any third party by registration of the pledge on the issuer's shareholders' list.

Shares that are listed are subject to the book-entry system controlled by Japan Securities Depository Center, Inc and no certificate is issued. A pledge over listed shares is created and perfected by registering the pledge with the pledgor's account established at the applicable institution under the book-entry system following a security agreement between a pledgor and a pledgee.

Intellectual property

Patents, trademarks, utility model rights and design rights can be pledged or assigned as security. A pledge or security over the intellectual property can be created and perfected by registering with the Japan Patent Office following a security agreement between a pledger or assignor and a pledgee or assignee. The registration fee for pledge is 0.4 per cent of the loan amount, while that for assignment as security is ¥15,000 (patent), ¥30,000 (trademark) or ¥9,000 (utility model right and design right) per patent, trademark, utility model right or design right, respectively.

Copyrights may also be pledged or assigned as security. A pledge or security is created by a security agreement between a pledger or assignor and a pledge or assignee and perfected by registering with the Agency for Cultural Affairs. The registration fee for pledge is 0.4 per cent of the loan amount, while that for assignment as a security is ¥18,000 per copyright.

In practice, pledges are more commonly used compared with assignments as security, but the secured loan amount to be registered is often reduced to lower the registration fee.

Contractual position

Contractual positions may be subject to an option agreement, under which they may be transferred to a lender or a person who is designated by the lender upon the occurrence of an event of default. This arrangement is relatively common in project finance transactions and is used to secure the lender's option to transfer all contractual relationships that an existing borrower special purpose company (SPC) has to a new SPC at the lender's option, in the event of default. To secure the lender's option, an acknowledgement with a stamp of a fixed date should be obtained by a third-party obligor, or notice with a stamp of a fixed date should be delivered to him or her.

Security interests for syndicated loans

Under the Japanese practice of syndicated loans, it is common that lenders appoint a security agent for administrative purposes only. A security agent does administrative work such as sending out notices on behalf of lenders, but cannot enforce the security interests on behalf of lenders. For syndicated loan transactions, instead of a scheme using a security agent, a security trust scheme, under which a security trustee can enforce security interests on behalf of lenders, can be adopted. The security trust scheme is, however, not commonly used in practice, partially because this is a relative new scheme introduced in 2007 and there are some practical issues, in addition to issues of cost.

Security interests to secure bonds

Under Japanese law, a trustee is required to be appointed to create security interests to secure bonds. Because of this requirement, it is not common for bond holders to take security.

Some specific laws, however, provide that all assets belonging to a certain type of bond issuers (such as utility companies, a certain special purpose company) shall be subject to security interests without any actions.

ii Guarantees and other forms of credit support

Guarantees are commonly used as in the case of a parent company's guarantee for debts owed by its subsidiary. Unless a guarantee agreement stipulates that a guarantor is severally and jointly liable against a lender, a guarantor may claim that a lender should make a first demand against the debtor and take first recourse over the debtor's asset, before making a demand against the guarantor.

Set-off works as quasi-security. For example, a bank may provide loans to its depositor on the condition that the bank offsets outstanding loan amount with deposits and thereby secures the loans. In addition, authorisation by a debtor to a lender to receive payments in combination with set-off is used as quasi-security. Under this authorisation structure, a debtor authorises a lender to receive payment from a third-party obligor against whom the debtor has a monetary claims and the lender offsets its outstanding loans to the debtor with its obligation to repay money that the lender receives from the third party.

Negative pledge undertakings are commonly provided in loan agreements, although the undertaking is a contractual obligation that may trigger an event of default when the debtor breaches the undertaking.

iii Priorities and subordination

Debt subordination is effected by intercreditor agreements. The security interests for subordinate lenders should be ranked after the interest of senior lenders. The rank or priority of security interests may be achieved by registering the ranks for security interests for which registration is made (such as mortgage and intellectual properties) or arranging the timing of the perfection for pledge (e.g., pledged assets are physically delivered to a senior lender at first and then constructively delivered to a subordinated lender). Please note that, as seen in Section IV.i, *supra*, it is not certain whether a concept of priority would exist for assignment as security.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal reservations

It should be noted that, in certain types of insolvency proceedings, exercisability of security interests will be limited or affected. In corporate reorganisation proceedings under the Corporate Reorganization Act (Act No. 154 of 2002, as amended), which is used for relatively large companies, secured lenders cannot exercise its security interests and they will receive repayment of the value of the collateral as of the commencement of the proceedings in accordance with the reorganisation plan. In civil rehabilitation proceedings under the Civil Rehabilitation Act (Act No. 225 of 1999, as amended), which is more commonly used for many companies, secured lenders may exercise their security interests as a general rule, although such an exercise may be temporarily stayed for reasonable period if the court finds that the stay conforms to the common interest of the ordinary unsecured creditors and is not likely to cause undue damage to the secured lender. In bankruptcy proceedings under the Bankruptcy Act (Act No. 75 of 2004, as amended), secured lenders may exercise their security interests without stay.

ii Practice with regard to legal opinions

Project finance transactions in Japan involve the borrower's legal counsel submitting a legal opinion, which opines, among other things, the borrower's capacity and validity and enforceability of transactions documents and security interests, to lenders. Disclosure of the legal opinion is typically limited to lenders and their advisers.

iii Governing law and jurisdiction

The courts of Japan will observe and give effect to the choice of foreign law as the governing law to the extent that such a choice of law is valid under the foreign law, except where a Japanese court could not determine what the law of the foreign law is or finds that the application of the foreign law would result in a violation of public order or good morals of Japan. In addition, Japanese courts will observe and give effect to the submission to the jurisdiction of a court of foreign countries unless:

a the relevant disputes are subject to the exclusive jurisdiction of Japanese courts; or
b such a court in a foreign country designated by parties does not accept jurisdiction in the relevant proceedings.

Final and conclusive judgment obtained in a court in a foreign country will be recognised by Japanese courts and will be enforceable, provided that:

a the jurisdiction of the court is admitted under the laws of Japan;
b the debtor has been served by a summons and not by public notice (or notice comparable thereto) or has appeared before such a court in a foreign country;
c the judgment is not contrary to the public order or good morals of Japan; and
d there exists reciprocity as to recognition of a final judgment obtained in the court of Japan by a court in a foreign country.

VI LOAN TRADING

The practice in Japan is that loans are commonly traded. The most common method of loan trading is an assignment. A loan purchaser may obtain security interests and guarantees automatically along with the loan receivables, although perfection process is required for the loan purchaser.

Revolving security (e.g., revolving mortgage) or revolving guarantee, which secures unspecified debts, however, shall not be transferred to the loan purchaser unless a security provider or guarantor consents to the transfer. Thus, such consents should be obtained upon the transfer of the loan.

VII OUTLOOK AND CONCLUSIONS

The reform bill for the Japanese Civil Code has passed the Diet on 26 May 2017. The law to amend the Civil Code was promulgated on 2 June 2017 and will be put into force within three years of the promulgation (namely by June 2020). The Civil Code had remained largely unchanged for more than 100 years, and the target of the reform was the area of claims (mainly Chapter III of the Civil Code). The impact of the reform would be relatively limited, as the amendments in this area mostly relate to codifying rules already established through court precedents.

That being said, there are a number of important changes that would impact the current lending practice; for instance, the change on the rules relating to restriction on transfer or assignment of claims. This change could, in the near future, promote new types of finance transactions including assignment of a number of accounts receivables.

Chapter 16

LUXEMBOURG

Henri Wagner and François-Guillaume de Liedekerke[1]

I OVERVIEW

Luxembourg is generally perceived as one of the most attractive business centres in the world. With approximately 145 registered banking institutions, more than €3,600 billion of assets managed by more than 3,800 undertakings for collective investment, a successful private equity industry and a dynamic insurance sector, Luxembourg offers a full range of diversified and innovative financial services.

The financial sector remains Luxembourg's main growth engine, accounting for a quarter of GDP and directly employing 44,000 full-time equivalents, which corresponds to 12 per cent of Luxembourg's labour force.

While the main activity of Luxembourg banks is international financial intermediation, private banking is an important pillar of the financial industry in Luxembourg. It is the largest in the eurozone and is ranked sixth in the world.

The move towards greater consolidation in the banking sector, which surfaced in recent years, has become one of the key features of the financial landscape in Luxembourg. Market players have to deal with mergers, restructurings and closing of lines of business.

The Luxembourg lending market is characterised by a growing presence of alternative credit providers. Luxembourg has the advantage of an experienced regulatory authority, the Luxembourg Financial Supervisory Commission (CSSF), which has clarified certain exemptions for Luxembourg lending platforms.

In recent years, Luxembourg has taken major initiatives to further increase its attractiveness, like the development of a sophisticated fintech industry, the creation of an important offshore Chinese renminbi hub and the furtherance of Islamic finance projects.

Recent trends and legal developments offer the Luxembourg financial sector excellent growth opportunities. Particular points of interest are the lender-friendly security interest regime, the Luxembourg fiduciary act and the double Luxco structure.

II LEGAL AND REGULATORY DEVELOPMENTS

i Security interests

In the aftermath of the economic crisis and the financial markets turmoil in 2008, financial collateral arrangements have attracted considerable attention from market participants. The Luxembourg Act dated 5 August 2005 on financial collateral arrangements, as amended

1 Henri Wagner is a partner and François-Guillaume de Liedekerke is counsel at Allen & Overy. The authors wish to thank Simeon-Henri de Vries for his assistance.

(the Collateral Act 2005),[2] provides for an attractive legal framework for security interests, liberalised rules for creating and enforcing financial collateral arrangements and protection from insolvency rules. It applies to any financial collateral arrangements, irrespective of the nature of secured liabilities or the status of the pledgor or the pledgee and covers financial instruments in the widest sense as well as cash claims or receivables.

The Collateral Act 2005 was amended in 2011 with a view to enhance the attractiveness of Luxembourg as an international finance centre.[3] It now confirms that the insolvency safe harbour provisions also apply to foreign law-governed collateral arrangements entered into by a Luxembourg party, which are similar to the Luxembourg financial collateral arrangements. It provides that receivables pledges are validly created among the contracting parties and are binding against third parties as from the date of entering into the pledge agreement. It also modernised the enforcement mechanism by allowing the collateral taker to appropriate, out of court, the pledged assets at a price determined after the appropriation of the asset and to direct a third party to proceed with the appropriation in lieu of the collateral taker. It is finally worth noting that the number of perfection mechanisms for pledges over book-entry securities has been increased by sanctioning different change of control mechanisms set forth in the American Uniform Commercial Code as additional perfection alternatives.

ii Fiduciary Act 2003

The Luxembourg Act of 27 July 2003 on the trust and on fiduciary contracts, as amended (the Fiduciary Act 2003)[4] continues to offer interesting structuring opportunities. Pursuant to fiduciary agreements governed by the Fiduciary Act 2003, a fiduciary or creditor obtains the ownership of the transferred assets. These assets are not part of its personal estate and may not be seized by its creditors in that they will form part of a segregated 'fiduciary property'. The Fiduciary Act 2003 expressly states that fiduciary agreements may be used for security purposes. Fiduciary agreements are, in principle, available for all types of assets, including shares, marketable financial instruments, bank assets, equipment, raw materials and inventory, intellectual property rights, claims and receivables.

iii Double Luxco

The double Luxco structure (the Double Luxco) has been developed in connection with the French leveraged buyouts (LBO) market to provide a response to the challenges of French insolvency laws. It is now used in LBO transactions across Europe.

Under French law, as well as in other European civil law jurisdictions, secured debt needs to be due and payable for lenders to enforce their security package. This often means that secured lenders will be required to accelerate the financing prior to enforcement. However, in such a case, there is a significant risk that the borrower would apply for some form of insolvency proceedings and as result prevent the secured lenders from enforcing their security.

In this context, the aim of the Double Luxco is to shift the enforcement point towards the Luxembourg jurisdiction, which is considered to be creditor-friendly and which does not require that secured debt be due and payable for lenders to enforce their security package.

2 *Mémorial A* – No. 128 of 16 August 2005.

3 Act of 20 May 2011 on the business of electronic money institutions, *Mémorial A* – No. 104 of 24 May 2011.

4 *Mémorial A* – No. 124 of 3 September 2003.

In a Double Luxco, the acquisition vehicle (for example, a French special purpose vehicle) is held by a Luxembourg vehicle (Luxco 1), itself held by another Luxembourg vehicle (Luxco 2). Each of the Luxcos will give a pledge over the shares, any other debt or quasi-equity it owns in its subsidiary as security for the repayment of the borrower debt.

The key component of the structure is to create a security interest under Luxembourg law granted by Luxco 1 over the shares in Luxco 2 that, pursuant to Article 8 of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the European Insolvency Regulation),[5] is located in Luxembourg and, therefore, remains subject to Luxembourg law. The risk that the borrower or the Luxembourg entities would file for, for example, safeguard proceedings in France on the basis that it had its centre of main interest in France (known as the centre of main interests (COMI) shift), is thus mitigated. The European Insolvency Regulation, which is the recast of Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings, as amended,[6] entered into force from 26 June 2016 and applies to insolvency proceedings from 26 June 2017. The key changes include, among others, a new definition of COMI (cf. Section VII.i, *infra*) and the introduction of new rules to determine the location of assets (e.g., cash held in accounts with a credit institution is located in the Member State indicated in the account's IBAN).

Some additional features have been built into the Double Luxco structure that allow the beneficiaries of a share pledge to vote on certain matters as if it was a shareholder without having to enforce the share pledge.

iv Alternative credit providers

According to the Luxembourg act dated 5 April 1993 relating to the financial sector, as amended (the Banking Act 1993), any person granting loans on a professional basis, must hold a licence of a credit institution or a professional in the financial sector carrying on lending activities in Luxembourg. In particular, Article 28-4 of the Banking Act 1993 defines professionals carrying on lending operations as professionals whose activity consists in granting loans to the public for their own account (without calling on public savings to refinance themselves). Article 28-4 not only covers the origination of loans[7] (on a primary basis), but also the acquisition of undrawn or partially drawn loans (on a secondary basis) by a Luxembourg entity. Financial leasing and factoring activities also fall under Article 28-4.

Nonetheless, in certain instances lenders will be able to benefit from an exemption from licensing requirements under Article 28-4 of the Banking Act 1993. For instance, securitisation transactions are expressly excluded from its scope. There are also exemptions (by way of interpretation and administrative practice) that are granted by the CSSF (the CSSF Exemptions) insofar as loans are not granted to the public. The CSSF describe the notion of public in a negative way and consider that a 'limited circle of persons previously known to the lender' do not fall within the notion of public. To assess the meaning of 'restricted circle of persons previously known to the lender', the CSSF apply two cumulatively criteria:

5 [2015] OJ L 141/19.

6 [2000] OJ L 160/1.

7 On 9 June 2016, the CSSF updated its FAQ concerning the Luxembourg Act dated 12 July 2013 on alternative investment fund managers, which includes FAQ 22 relating to AIFM/AIF engaging in loan origination or loan participation or acquisition. This FAQ is available at: www.cssf.lu/fileadmin/files/AIFM/FAQ_AIFMD.pdf.

a the number of persons concerned must be limited (though the CSSF do not set a cap for the number of people above which the restricted circle does no longer exist); and
b the persons concerned must be identified or identifiable in the sense of an existing relationship or a relationship that is in the process of being built on the basis of objective predetermined criteria (before the granting of the loans).

Furthermore, the requirement under Article 28-4 to hold a licence for carrying on lending activities only applies to the extent that loans are granted 'on a professional basis'. In other words, the granting of loans must be a regular occupation or a business activity. The reference to the professional character of the lending activity implies that it is performed repetitively and that unique or one-off lending operation are subject neither to Article 28-4 above, nor to the Banking Act 1993 in general. In the same vein, the acquisition of fully drawn loans would normally be exempted from licensing requirements, as this would not be regarded as the granting of a loan. Where partially drawn or undrawn loans are concerned, or where the transfer concerns loans that have been entered into simultaneously or immediately prior to the transfer of the loans, it is likely that Article 28-4 will kick in (unless one of the CSSF Exemptions is available).

III TAX CONSIDERATIONS

i Withholding tax

Interest payable under, or with respect to, Luxembourg law or foreign law loan agreements or security arrangement agreements may, in principle, be made free and clear of, and without withholding or deduction for or on account of, withholding tax in Luxembourg,[8] provided that:

a all payments and transfers made by, on behalf of, in favour of, or for the account of, the Luxembourg company under such agreements, are made on an arm's-length basis and are in accordance with market practice;
b the Luxembourg company is not, is not deemed to be and, as a result of entering into and performing such agreements, will not be over-indebted in light of the current practice of the Luxembourg tax administration; and
c none of the parties to such agreements will have any relation with the Luxembourg company other than that of an independent third party acting in the normal course of its business or will maintain any particular economic relation with the Luxembourg company, other than that contemplated by such agreements.

ii Registration duties

There are, in principle, no stamp, registration or similar taxes, duties or charges under the laws of Luxembourg payable in connection with the execution, performance, and enforcement by the relevant parties of Luxembourg law or foreign law loan agreements or

8 This remains subject the application of Luxembourg law of 23 December 2005 as amended, introducing a withholding tax of 20 per cent on payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the benefit of an individual beneficial owner who is resident of Luxembourg.

security arrangement agreements, except security interests that must be registered with public authorities in Luxembourg (such as mortgages over real estate property, aircraft or ships, general business pledges, pledges over IP rights, etc.), subject to the following.

The registration of any such agreements with the Administration of Registration and Domains in Luxembourg will be required in the case that any such agreements are physically attached to a public deed or to any other document subject to mandatory registration, in which case either a nominal registration duty or an *ad valorem* duty (e.g., 0.24 per cent of the amount of the payment obligation mentioned in the document so registered) will be payable depending on the nature of the document to be registered.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Security interests governed by the Collateral Act 2005

The Collateral Act 2005 is regarded as one of the most creditor-friendly legal frameworks for security interests globally. It contemplates liberalised rules for creating and enforcing financial collateral arrangements and shields financial collateral arrangements from insolvency proceedings. The Collateral Act 2005 expressly provides that financial collateral arrangements (including pledges) are valid and enforceable, even if entered into during the pre-bankruptcy period (the 'hardening' or 'suspect' period), against all third parties including insolvency receiver, liquidators and other similar persons irrespective of any insolvency, liquidation or other situation affecting anyone of the parties (save in the case of fraud).

The Collateral Act 2005 applies to any financial collateral arrangements, regardless of the status of the pledgor or the pledgee and of the nature of secured liabilities and covers financial instruments in the widest sense as well as cash claims or receivables. Accordingly, pledges over shares, book-entry securities, intra-group loan receivables and pledges over bank accounts may benefit from this attractive framework.

The Collateral Act 2005 also provides for transfers of title by way of security and recognises the right of the pledgee to re-hypothecate the pledged assets. It enables the pledgee to use and dispose of the pledged assets. Contractual arrangements allowing for substitution and margin calls are expressly recognised by the Collateral Act 2005 and are protected in insolvency proceedings (in respect of which, security interests other than those covered by the Collateral Act 2005 and granted during the pre-bankruptcy suspect period can be challenged).

Creation and perfection requirements

The Collateral Act 2005 provides for a liberalised set of rules for creating and perfecting securities. As such, pledges over shares will be validly created and enforceable against third parties (depending on the type of company whose shares are pledged), by the execution of the pledge agreements or the registration of the pledge in the shareholders' register of the company concerned in the case of registered shares, or by the effective transfer of the shares to the pledgee (or a third party appointed by the pledgee) in the case of shares in bearer form, or by the registration of the pledge in the register of the depositary in the case of immobilised bearer shares. Other rules apply in the case of shares in book-entry form.

A pledge over intra-group loans or receivables governed by Luxembourg law or owed by a Luxembourg obligor is validly created and enforceable against third parties by the execution by the pledgor and the pledgee of the pledge agreement, and binding against the debtor upon the debtor having knowledge of the creation of the pledge. Future intra-group loans or receivables may be pledged, provided that they are determinable at the time the pledge is granted. Depending on the nature of receivables, the practice is to cover new receivables by establishing lists of receivables on a regular basis and servicing notices accordingly.

A pledge over bank accounts held with a credit institution in Luxembourg typically covers cash and book-entry securities. The pledged account can be either blocked or operated pursuant to the parties' agreement. The pledge will be notified to the depositary bank or, as applicable, consent will be obtained from the depositary bank as to:

a acceptance of the pledge by the depositary bank; and

b waiver and exclusion of bank set-offs and general pledge (available under general business conditions of Luxembourg banks).

Enforcement measures[9]

Under the Collateral Act 2005, pledgees can benefit from enforcement measures that are generally viewed as creditor-friendly. A pledgee may enforce a pledge, without the obligation of prior notice to the pledgor, in its absolute discretion and in the most favourable manner provided by it.

In the case of a pledge over shares, the pledge may generally be enforced by the pledgee by way of:

a out-of-court appropriation of the shares at a price determined pursuant to a valuation method agreed upon by the parties in the pledge agreement (i.e., typically a valuation to be carried out by an independent auditor or an investment bank chosen by the pledgee at the time of enforcement); or

b out-of-court private sale on arm's-length commercial terms (i.e., the sale must be made at a price that a well-informed independent willing buyer would normally, under relevant market conditions and taking into account the information available at that time, be prepared to pay to a willing seller).

The pledge agreement will typically provide for the possibility to enforce the pledge agreement by way of appropriation before the valuation has been commenced or completed, which may allow for the pledge to be enforced by the pledgee overnight. However, the pledgee may decide, depending on the particular circumstances and to reduce the risk of post-enforcement liability proceedings, to wait for the valuation to be completed before enforcing the pledge.

Under the Collateral Act 2005, the parties are free to determine the trigger event for enforcing a security interest. This can be an event of default of a non-payment type or any other event agreed upon by the parties, the occurrence of which will entitle the pledgee to enforce the security. However, an enforcement of a pledge triggered by an event of default other than a payment default may raise practical difficulties that will need to be carefully assessed on a case-by-case basis.

Comparable attractive enforcement methods exist for pledges over accounts or receivables. Furthermore, a pledge over an account and a pledge over receivables may generally

9 For further information on this topic, we refer to 'Enforcing financial collateral arrangements in the new world – challenging times!', Henri Wagner and François-Guillaume de Liedekerke, *Bulletin Droit et Banque*, No. 47, April 2011.

be enforced by the pledgee by requesting payment to it by the bank where the account is held of the pledged assets or by the debtor of the pledged receivables, in and towards full payment and discharge of the secured liabilities.

Enforcement measures under the Collateral Act 2005 may undoubtedly be considered as being highly attractive to lenders. Therefore, and to the extent possible, market practice in Luxembourg consists of bringing a security package within the scope of the Collateral Act 2005.[10]

Other security interests

Luxembourg also has a trial-tested and relatively creditor-friendly security interest regime outside the Collateral Act 2005, and security interest can normally be taken over a wide range of assets.

Mortgages over real estate property, aircraft or ships located in Luxembourg

A mortgage may be taken over real estate property or aircraft and must be drafted in the form of a notarial deed. A mortgage over ships may be constituted by a private written agreement or a notarial deed. The mortgage agreement or deed must specify the assets covered precisely and must be registered at the mortgage registry of the judicial district in which the real estate property is located, in the maritime registry or in the registry for aircraft mortgages, as the case may be, to be valid and enforceable against third parties. Registration is subject to *ad valorem* taxes and translation requirements, and is valid for 10 years (renewable). The mortgage may be granted only to secure a sum of money that is certain and determined. The mortgage does not cover rentals and insurance policy proceeds, which must be separately pledged.

Pledges in respect of proceeds from insurance policies

A pledge can be granted in respect of proceeds from insurance policies. Such pledge will be subject to similar rules as for a pledge over receivables.

Pledges over intellectual property rights

A pledge can be granted over patents. Pledges over copyrights (and, to a certain extent, over trademarks and models or designs) are subject to debate and require a case-by-case analysis. For validity and enforceability between the parties and against third parties, pledge agreements relating to patents, trademarks and models or design must be registered with the appropriate national or international intellectual property registration authorities.

10 A number of closely watched court decisions have recently strengthened the legal security and attractiveness of financial collateral arrangements subject to the Collateral Act 2005. For example, the decision of the Court of Appeal sitting in summary proceedings, No. 35824, 3 November 2010, which confirmed that the enforcement of a pledge agreement made in accordance with the terms of the pledge agreement may in principle not be challenged and that only action for liability may potentially be taken against the pledgee. Luxembourg courts have also limited the possibility to appoint a receiver or administrator in the context of enforcement procedures of financial collateral arrangement as long as enforcement measures comply *prima facie* with the conditions provided for in the pledge agreement (Court of Appeal sitting in summary proceedings, No. 346743, 3 June 2009 and Luxembourg District Court sitting in summary proceedings, 11 February 2010).

General business pledges

A general business pledge is available under Luxembourg law and covers clientele; business name and goodwill; licences; trademarks and patents; leases; furniture; materials; rolling stock and other tools; and 50 per cent of the value of the inventory. Receivables, securities and cash must be expressly included to be covered by the pledge (although there are no Luxembourg court precedents to confirm the validity of such inclusion). The general business pledge is only available over industrial or commercial business conducted in Luxembourg and can only be granted to credit institutions (and, for historic reasons, breweries) authorised specifically by the Luxembourg government to that end.

For validity and enforceability against creditors, the pledge must be registered at the mortgage registry of the judicial district in which the business is located. Registration is subject to *ad valorem* taxes and translation requirements, and is valid for 10 years (renewable).

Satellites, rights to orbital slot and customer contracts

For assets like satellites, rights to orbital slot or customer contracts, it may be difficult to obtain a valid Luxembourg law security interest and it would accordingly be preferable to restrict transfers of such assets to companies in Luxembourg.

Under Luxembourg law, contracts providing for reciprocal obligations of the parties may not be pledged as such. A pledge may, however, be granted over the monetary or restitution claims resulting from the contracts. An analysis of the customer contracts, as well as of the contractual documentation relating to satellites and rights to orbital slots, may be needed to determine if Luxembourg security interests over those assets would be appropriate.

A possible alternative could be to subject those assets (according to the *lex rei sitae* rule) to foreign law security interests, provided that such laws allow for such security interests and that the assets, though owned by the Luxembourg companies, are not located (or deemed to be located) in Luxembourg.

ii Guarantees and other forms of credit support

Besides security interest rights, Luxembourg law also provides for security in the form of personal guarantees like a suretyship, an independent or demand guarantee or a letter of comfort.

Suretyship

A suretyship is an agreement made between the surety and the debtor whereby the surety undertakes to pay the debtor's debt in the case the debtor is unable to make the payment. It is subject to the validity of the underlying obligation (e.g., a facility) and to all the defences that apply to the underlying obligation, which means that the surety may use all exceptions available to the debtor against the beneficiary of the suretyship.

In the case the suretyship is granted by a natural person, pursuant to Article 2016 of the Luxembourg Civil Code:

a if a creditor who benefits from such a suretyship does not inform the natural person at least once a year about the evolution of the guaranteed claim and its accessories, the creditor will no longer be entitled to the claim's accessories (including interest), costs and penalties; and

b a professional creditor is not entitled to rely on a suretyship agreement entered into by a natural person whose commitment was, at the time of the entry into the suretyship agreement, obviously disproportionate to this person's assets and income, unless at the time the surety is called, this person's estate enables him or her to comply with the related payment obligation.

While there is, to our knowledge, no Luxembourg (published) case law on this point, it cannot be excluded that a Luxembourg court would hold Article 2016 of the Luxembourg Civil Code to be a point of international public policy that would set aside the relevant foreign governing law.

A suretyship is generally considered to provide for some level of comfort to a creditor under Luxembourg law depending on the particularities of the transaction, although lenders usually require more robust types of guarantees.

Independent or demand guarantee

An independent or demand guarantee is a commitment having an autonomous nature, which shall expressly set out that:

a it is a demand guarantee and not a suretyship (although despite the expressed common intention of the parties to this effect, the guarantee could be construed by the relevant competent court as a suretyship);

b the obligations of the guarantor constitute an autonomous guarantee that is not an accessory to the principal underlying obligation (e.g., a facility); and

c the guarantor agrees that any invalidity relating to the underlying obligation would not cause the demand guarantee to be null and void.

While being in a stronger position than in the suretyship, the beneficiary of the demand guarantee will not be protected in the case of bankruptcy of the guarantor, and its claim will rank *pari passu* with the other creditor of the guarantor.

Letter of comfort

A letter of comfort is a document generally issued by a bank or a parent company that provides for an assurance as to the debt of the debtor. The legal force of such letter will depend on the exact terms therein. It should therefore be drafted in a way that the issuer undertakes an obligation of results. However, in the case of default, even with a firm letter of comfort, the issuer could not be forced to perform the debtor's obligation but only to indemnify the creditor for any (proven) damages.

iii Priorities and subordination

The validity of certain clauses and provisions pertaining to subordination and priorities is not entirely settled under Luxembourg law, and the possibility that such clauses would be voided on public policy grounds cannot be entirely excluded.

There are no general Luxembourg law provisions or regulations on contractual subordination (other than under Luxembourg banking, insurance and securitisation legislations), no Luxembourg well-established (published) case law and only little legal literature on the validity and enforceability (under Luxembourg law) of contractual subordination. Contractual subordination would be upheld by Luxembourg courts, even in the event of insolvency proceedings affecting the Luxembourg party concerned (although there is uncertainty as to whether an insolvency receiver of a Luxembourg party debtor would accept the hierarchy between senior and subordinated creditors of this Luxembourg party).

To assess contractual subordination in general, Luxembourg courts would mainly turn to Belgian case law and legal literature, which seem to admit the validity and enforceability of a provision whereby a party agrees to subordinate its claim to the claim of another (senior) creditor.

It is also generally held that a junior creditor may agree to subordinate his or her claim, whether or not secured, to that of a senior creditor by agreeing to turn over (transfer) proceeds of the junior claim and its security to the extent necessary to pay the senior claim. Notice to the common debtor is not necessary for the validity of the turnover against creditors of the junior creditor. However, from a Luxembourg law perspective, turnover provisions might be regarded as a mere contractual mechanism and would not give the senior creditor a proprietary claim on the insolvency of the junior creditor. In the case that a junior creditor has been paid before a senior creditor and bankruptcy proceedings are instituted against the junior creditor before the amounts so paid to the junior creditor have been paid and distributed to the senior creditor, it is uncertain whether the senior creditor would be able to claw back these amounts from the junior creditor. There is uncertainty whether a Luxembourg insolvency receiver of a debtor subject to Luxembourg insolvency proceedings would, where applicable, accept the hierarchy between senior and subordinated creditors of this debtor.

Luxembourg law does not contain a specific legal provision that expressly recognises limited recourse provisions, nor is there any Luxembourg (published) case law or well established legal literature dealing with such clauses. Nonetheless, Belgian case law (to which Luxembourg courts often turn in these instances) seems to admit the validity and enforceability of a provision whereby contractual arrangements are established in conformity with contact law to the extent that they do not grant to a particular creditor a better rank in the distribution of the debtor's assets. The principle of *pari passu* treatment of creditors (according to which contractual arrangements, entered into prior to the opening of insolvency proceedings and designed to unfairly benefit one creditor to the detriment of other creditors by giving it a preferential right not provided for by law, are unlawful) aims only at protecting the rights of all the creditors, and as such is public policy. In other words, the debtor may not, by an arrangement with one of its creditors, impair the rights of the other creditors. Nothing however prohibits one or more creditors to limit, to derogate from, or even to renounce their rights in the sense that they dispose of their own rights without altering other creditors' rights.

Non-petition clauses (that is, a clause whereby one or more parties waive *ab initio* their right to institute bankruptcy proceedings against their debtor) are likely to not be recognised under Luxembourg law. Although there is no specific Luxembourg case law or legal literature, Belgian case law does not recognise the enforceability of a non-petition clause because it violates public policy.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Luxembourg law generally upholds the principle of legal and contractual certainty, and legal reservations may be less intrusive than other continental European jurisdictions. Nonetheless, its civil law heritage means that lenders will have to take into account certain public policy considerations.

i Financial assistance and corporate benefit

Assuming the grantor of guarantee is a private limited liability company or a public limited liability company (which is typically the case for Luxembourg holding companies), some guidance as to the granting of guarantees and guarantee limitation is necessary. It is worth noting, however, that guarantee limitations would normally not apply where the security grantor grants financial collateral governed by the Collateral Act 2005 or other security interests.

A company may give a guarantee provided the giving of the guarantee is covered by the company's corporate objects and in the corporate interest of the company. In other words, a group guarantee must comply with the principle of speciality (the Corporate Objects Test) and company law (the Corporate Benefit Test).

As regards the Corporate Objects Test, the giving of a guarantee does not necessarily fall within the scope of a company's corporate objects. This point must be analysed on a case-by-case basis in light of the guarantor's corporate objects clause in its articles of association.

As regards the Corporate Benefit Test, the managers or directors of a company must act in the best interest and for the corporate benefit of the company. The giving of a guarantee in support of a third party's indebtedness is not necessarily *ultra vires* if the transaction furthers, even indirectly, the corporate purpose of each guarantor. The test is whether the company that provides the guarantee receives some consideration in return (such as an economic or commercial benefit) and whether the benefit is proportionate to the burden of the assistance. Accordingly, a guarantee that could adversely affect the creditors of the company is not necessarily, *per se*, against the company's best interest. However, a guarantee that substantially exceeds each of the guarantor company's ability to meet its obligations to the beneficiary of the guarantee and to its other creditors would expose its directors to personal liability. It is, therefore, prudent (for upstream or cross-stream guarantees) to limit the guarantee to a percentage (normally between 80 per cent and 100 per cent) of the company's net worth (or similar reference value) so that, at least in accounting terms, the guarantee does not adversely affect the creditors of any of the guarantors.

It follows that a Luxembourg company may, in principle, provide a guarantee for the benefit of other group companies if it can be demonstrated that:

a the company belongs to a group of companies that has a real structure and is organised in the view of a common economic, industrial and commercial policy;

b the company derives a benefit from giving the guarantee; and

c the guarantee amount is not disproportionate to the company's financial means.

For an upstream or cross-stream guarantee, the insertion of a limitation language will generally be required by the company acting as a guarantor. The same limitations do not apply for downstream guarantees.

If the assistance is deemed contrary to the interest of the company by the courts, its directors may be held liable for action taken in that context. Further, under certain circumstances, the directors of the Luxembourg company might incur criminal penalties based on the concept of misappropriation of corporate assets (Article 171-1 of the Luxembourg act dated 10 August 1915 on commercial companies, as amended (the Companies Act 1915)). Article 171-1 of the Companies Act 1915 makes it a criminal offence for the directors and managers of a Luxembourg company, whether having been officially appointed or being *de facto* directors or managers (which concept might include legal persons), if, acting in bad faith, they have made use of corporate assets or of corporate credit for uses other than those required by the interests of such company and for their own personal benefit or for the benefit of companies or enterprises in which they have a direct or indirect interest. It cannot be excluded that, if the relevant transaction were to be considered as a misappropriation of corporate assets by a Luxembourg court, or if it could be evidenced that the other parties to the transaction were aware of the fact that the transaction was not for the corporate benefit of the Luxembourg company, the transaction might be declared void or ineffective based on the concept of illegal cause. Also, depending on the factual circumstances, a liquidator, an insolvency receiver or creditors of the assisting company could seek the liability of the banks (e.g., where the guarantee trigger has caused the insolvency of the assisting company or has caused a wider consequential loss to the creditors of such company).

In the case of a public limited liability company, parties will have to take into consideration specific financial assistance rules. According to Article 49-6 of the Companies Act 1915, a public limited liability company is prohibited from granting loans, guarantees or advancing funds to a third party for the acquisition of its own shares unless a 'whitewash' type of procedure is followed.

There are currently no specific rules under Luxembourg law prohibiting such financial assistance regarding the acquisition of shares in a private limited liability company.

ii Insolvency proceedings and hardening period rules

Insolvency situations are governed by a set of rules that have been elaborated by courts and legal literature around the cardinal principle of *pari passu* ranking of creditors. Under applicable Luxembourg law, it is possible for a company to be insolvent without necessarily being bankrupt. If a company fails to meet the two cumulative tests of bankruptcy, namely the cessation of payments and the loss of creditworthiness, it is not deemed bankrupt. The judgment declaring the bankruptcy, or a subsequent judgment issued by the court, usually specifies a period not to exceed six months before the day of the judgment declaring the bankruptcy. During this period, which is commonly referred to as the suspect period, the debtor is deemed to have been already unable to pay its debts generally and to obtain further credit from its creditors or third parties. Payments made, as well as other transactions concluded or performed, during the suspect period, and specific payments and transactions during the 10 days before the commencement of that period, are subject to cancellation by the Luxembourg court upon proceedings instituted by the Luxembourg insolvency or bankruptcy receiver.

iii Enforcement of foreign judgments

A final and conclusive judgment in respect of agreements obtained against a Luxembourg company in a EU Member State court would be recognised and enforced by the Luxembourg courts without re-examination of the merits of the case subject to and in accordance with the Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).[11] This is provided that the judgment in question qualifies as a judgment (as defined therein) or, as the case may be, is subject to and in accordance with

11 [2012] OJ L 351 /1.

Council Regulation 805/2004 of 21 April 2004 creating a European enforcement order for uncontested claims, provided that the judgment in question has been certified as a European Enforcement Order (as referred to therein).[12]

A final and conclusive judgment in respect of agreements obtained against a Luxembourg company in an Icelandic, Swiss or Norwegian court would be recognised and enforced by the Luxembourg courts without re-examination of the merits of the case subject to the applicable enforcement procedure and conditions of the Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters signed at Lugano on 30 October 2007.

A final and conclusive judgment in respect of agreements obtained against a Luxembourg company in another foreign court than the courts referred to above would be recognised and enforced by the Luxembourg courts subject to the applicable enforcement procedure (as set out in the relevant provisions of the Luxembourg New Civil Procedure Code). Pursuant to present Luxembourg case law, the enforcement of such judgment is subject to the following requirements:

a the foreign judgment must be enforceable in the country of origin;

b the court of origin must have had jurisdiction both according to its own laws and to the Luxembourg conflict of jurisdictions rules;

c the foreign proceedings must have been regular in light of the laws of the country of origin;

d the rights of defence must not have been violated;

e the foreign court must have applied the law that is designated by the Luxembourg conflict of laws rules or, at least, the judgment must not contravene the principles underlying these rules;

f the considerations of the foreign judgment as well as the judgment as such must not contravene Luxembourg international public policy; and

g the foreign judgment must not have been rendered as a result of or in connection with an evasion of Luxembourg law.

iv Legal opinion practice

The nature of legal opinion practice in Luxembourg is characterised by a certain level of flexibility, and a legal opinion may be given by either creditor counsel or debtor counsel as the case may be. Legal opinions are typically addressed to the finance parties, but disclosure to certain advisers such as auditors or regulators is generally accepted. In the case of primary syndication, it is market practice in Luxembourg to allow any lender joining the syndication within three months after the opinion has been issued to rely on the legal opinion.

VI LOAN TRADING

Most of the loan trading transactions in Luxembourg are carried out by inbound financial and credit institutions, and such transactions are normally governed by the law with which such institutions are most familiar (i.e., English or New York law). So far as the loan transfer and its effects are governed by English law, such choice of law is recognised in Luxembourg

12 [2004] OJ L 143/15.

pursuant to Regulation (EC) No. 593/2008 of the European Parliament and the Council of 17 June 2008 on the law applicable to contractual obligations, except in limited circumstances. The choice of New York law would equally be recognised, except in limited circumstances.

However, to the extent that it relates to Luxembourg assets, in most cases the security package will be governed by Luxembourg law, and market participants regularly seek advice on ensuring that secondary market purchasers obtain the benefit of Luxembourg security or guarantees (if any) after a loan transfer (the transfer).

If the security arrangement is a pledge or a suretyship, under Luxembourg law it will be transferred automatically together with the underlying main obligation (the pledge and the suretyship each being an accessory to the main obligations (Article 1692 of the Luxembourg Civil Code)). If the transfer is effected through a novation, the pledge or suretyship in question would lapse unless expressly reserved or confirmed, respectively, by the parties concerned.

If the security arrangement is a transfer of title by way of security (which is not an accessory to the underlying main obligation), the new transferee would require an express confirmation of the transfer from the transferor (as security provider). The same applies to autonomous independent personal guarantees.

In addition, Luxembourg market practice typically recommends 're-perfecting' the Luxembourg law-governed security arrangement following the transfer. For pledges over registered securities, the re-perfection is achieved by a new registration of the pledge in securities register; for pledges over bank accounts (cash or securities), the re-perfection is achieved by notice to the Luxembourg account bank relating to the identity of the new pledgee; for pledges over receivables, the 're-perfection' is usually achieved by notice to the debtor of the pledged receivables relating to the identity of the new pledgee. In all those instances, the relevant pledgor should arrange for such re-perfection or notification to be implemented. Timing will depend on the cooperation of the counterparty, where necessary. So far as personal autonomous guarantees and transfers of title by way of security are concerned, the guarantor's or the new transferor's (as security provider) consent would have to be obtained.

Additional steps would be required in the case of general business pledges, mortgages and pledges over intellectual property rights, patents, trademarks and copyrights.

Should loan trading transactions be carried out through alternative funds (such as alternative debt funds):

a additional requirements would derive from Directive 2011/61/EU of the European Parliament and of the Council dated 8 June 2011 on alternative investment fund managers and amending Directive 2003/41/EC and 2009/65/EC and regulations (EC) No. 1060/2009 and (EU) No. 1095/2010 (the Act on Alternative Investment Fund Managers (AIFMD)),[13] and the Luxembourg Act dated 12 July 2013 on alternative investment fund managers implementing the AIFMD;[14] and

b the obligations arising for the parties to such agreements would be subject to the AIFMD.

13 [2011] OJ L 174/1.

14 *Mémorial A* – No. 119 of 15 July 2013.

VII OTHER ISSUES

i Insolvency proceedings and COMI

The European Insolvency Regulation, which establishes common rules on cross-border insolvency proceedings, applies in Luxembourg. In broad terms, the European Insolvency Regulation provides that main insolvency proceedings are to be opened in the Member State where the debtor has his or her COMI. The European Insolvency Regulation defines COMI as 'the place where the debtor conducts the administration of its interest on a regular basis and which is ascertainable by third parties' and establishes a rebuttable presumption that in the case of a company or legal person the COMI is at the company's registered office. This presumption will not apply if the registered office has been moved to another Member State within the three months prior to the request for opening insolvency proceedings.

These proceedings will have universal scope and encompass a debtor's assets throughout the European Union (subject to secondary proceedings opened in one or more EU Member States although such proceedings will be limited to the assets in that state and will run in parallel to the main proceedings). Creditors will have the comfort that where a company has a branch or significant assets or activities in more than one EU Member State, the proceedings opened in one Member State will encompass assets located throughout the European Union and even those assets moved by the debtor to another Member State after the date of filing.

Main insolvency proceeding may be opened in Luxembourg if a company's COMI is located in Luxembourg and the conditions provided for under Luxembourg law for the opening for an insolvency proceeding are met. As regards bankruptcy proceedings, a Luxembourg company is bankrupt when:

a it has a commercial object or a commercial form;
b it has ceased its payments and is unable to meet its commitments; and
c its credit is exhausted.

In accordance with the principle of universality of insolvency proceedings, the assets owned directly by the bankrupt company or by one of its branches, located both in Luxembourg and in other jurisdictions, as a matter of Luxembourg law, form part of the insolvent estate. The powers of the receivers, appointed in connection with the bankruptcy of a company by a Luxembourg court, may be exercised over the assets located outside Luxembourg, subject to recognition abroad. For instance, this would include escrow monies held abroad to the extent they are still deemed, in accordance with local law, to belong to the insolvency estate.

Under the European Insolvency Regulation, the conditions under which set off is available are normally governed by the law of the Member State in which insolvency proceedings are opened. If the insolvency proceedings are commenced in Luxembourg, and Luxembourg law allows for insolvency set off, it will in principle be effective. In this respect, set off and close out netting are generally recognised and enforceable under the Collateral Act 2005.

ii Compounding of interest

The right to compound interest is not entirely accepted under Luxembourg law, and the validity of such clauses is limited, pursuant to Article 1154 of the Luxembourg Civil Code, to cases where:

a the interest has been due for at least one year; and *b* the parties have specifically provided in an agreement (to be made after that interest has become due for at least one year) that such interest may be compounded (or in the absence of such agreement, the creditor may file an appropriate request with the relevant court).

The provisions of Article 1154 of the Luxembourg Civil Code are generally considered to be a point of public policy under Luxembourg law, and would, therefore, apply to agreements governed by Luxembourg. For agreements that are not governed by Luxembourg law, it is possible, although it is unlikely, that a Luxembourg court would hold these provisions to be a point of international public policy that would set aside the relevant foreign governing law.

iii Powers of attorney and service of process agent

Unless otherwise provided for or unless the contrary results from the circumstances, a power of attorney or agency, whether or not irrevocable, will terminate by force of law, and without notice, upon the occurrence of insolvency events affecting the principal or the agent. A power of attorney or agency might become ineffective upon the principal entering into controlled management or reprieve from payment. The designation of a service of process agent may constitute (or may be deemed to constitute) a power of attorney or agency.

There are uncertainties under Luxembourg law as to the effectiveness or ineffectiveness of a purported revocation, or the consequences of such revocation by the principal of a power of attorney or agency expressed to be irrevocable.

iv Foreign law security interests and floating charge

Contractual security arrangements that are not expressly recognised under Luxembourg law, such as the assignment for security purposes of rights or assets other than those expressly covered by the Collateral Act 2005, might not be recognised or enforced by the Luxembourg courts, in particular where the Luxembourg security grantor becomes subject to Luxembourg insolvency proceedings (without prejudice to the creditor protective provisions of the European Insolvency Regulation) or where the Luxembourg courts have otherwise jurisdiction because of the actual or deemed location of the relevant rights or assets.

A floating charge over assets located in Luxembourg would in principle not be recognised by a Luxembourg court.

v Concurrent proceedings

The provisions of a jurisdiction clause whereby the taking of proceedings in one or more jurisdictions shall not preclude the taking of proceedings in any other jurisdiction whether concurrently or not, might not be entirely enforceable in a Luxembourg court. If proceedings were previously commenced between the same parties and on the same grounds as the proceedings in Luxembourg, a plea of pendency might be opposed in the Luxembourg court and proceedings either stayed pending the termination of the proceedings abroad or dismissed, as the case may be.

vi Recognition of trust

Luxembourg law recognises trusts referred to and subject to the reservations expressed in the Convention on the law applicable to trusts, and on their recognition achieved at The Hague on 1 July 1985. If the trust relates to, or applies in respect of, assets located in Luxembourg, the situation of the trustee will be determined by reference to the situation of the legal owner of such assets without prejudice to the principle of segregation of the trust's assets and the trustee's personal estate. This does not mean that trusts created abroad will necessarily be recognised by Luxembourg courts as to all their effects under their governing law. Under the Collateral Act 2005, a financial collateral arrangement may be created in favour of a person acting on behalf of the beneficiaries of the financial collateral arrangement, of a fiduciary or of a trustee, provided that the beneficiaries of the financial collateral arrangement, present or future, are identified or ascertainable.

vii Ranking of security interests

There are rights of preference (e.g., tax payments, social security charges and wages) existing by operation of law and ranking prior to the ranking of security rights.

viii True sale

Under Luxembourg law (Article 1689 of the Luxembourg Civil Code), an assignment agreement is validly created between the assignor and the assignee by their mutual consent. Such mutual consent operates a 'true sale' of the receivable among the seller and the assignee as a matter of Luxembourg law. However, the assignment will only be enforceable *vis-à-vis* the debtor and third parties (including creditors of the seller and its insolvency administrator) upon notification of the assignment to the debtor or acceptance thereof by the debtor.

ix EMIR

Certain transactions, such as transactions involving certain types of derivatives, may be subject to Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on over-the-counter derivatives, central counterparties and trade repositories[15] or any delegated or implementing regulations (together the EMIR Regulations) and, as a result, the obligations arising for the parties under such agreements would be subject to the EMIR Regulations.

VIII OUTLOOK AND CONCLUSIONS

The financial markets turmoil of 2008 has created a wave of consolidation in the banking sector and substantially reshaped the financial landscape in Luxembourg.

The enforcement of financial collateral arrangements, in the wake of the economic and financial markets turmoil of 2008, raised a number of issues that led to closely watched proceedings before Luxembourg courts. The general successfulness of lenders in defending actions against enforcement has strengthened the legal security and attractiveness of financial collateral arrangements governed by Luxembourg law. Moreover, the Luxembourg legislator has recently further strengthened the appeal of the Collateral Act 2005 by confirming that the insolvency safe harbour provisions also apply to foreign law-governed collateral arrangements that are similar to the Luxembourg collateral arrangement.

15 [2012] OJ L 201/1.

Regulatory changes have also had a significant impact on many market participants. The multitude of European and international legislative initiatives that were aimed at closing gaps in regulation and supervision that might adversely affect the stability of the international financial system, have also created increasing capital and reporting requirements.

In an uncertain regulatory environment, Luxembourg authorities have clearly aimed to differentiate themselves from their foreign counterparties by quality of service, responsiveness and approachability. In particular, the CSSF has in the past shown a desire to strike the right balance between increased supervision and the need for the financial sector to breathe and develop. While there is undoubtedly an international trend towards a common supervisory culture and a harmonised application of a single rule book, the CSSF seems committed to continue to advocate for a consensus-based model of supervision.

Luxembourg authorities have also taken considerable steps to promote Luxembourg as the premier international renminbi hub in the euro area and to solidify Luxembourg's position as one of the leading Islamic finance centres in Europe. As a result of these efforts, Luxembourg is now the leading European financial centre in terms of renminbi loans and deposits.

The Luxembourg government proposes to introduce the private foundation, as well as the structure of trust similar to the English law trust, into the Luxembourg legal framework, with a view to strengthen, among others, the Luxembourg wealth management and financial sectors. It is also currently being contemplated to overhaul the current Luxembourg insolvency regime and to put into place mechanisms that would help companies that are in difficulty to avoid bankruptcy proceedings.

Chapter 17

NETHERLANDS

Jean-Marc Rovers and Jan Marten van Dijk[1]

I OVERVIEW

The Dutch loan finance market for corporate borrowers is still mainly handled out of banks. It can roughly be divided into three market segments. The small market segment represents principal loan amounts of up to approximately €30 million, which are often lent by a bank in a relationship context and on a bilateral basis. These loans are often documented on the basis of the bank's own templates. When trading may be an option at a later stage, Loan Market Association (LMA) standards may also be used. Mid-market deals range from around €30 million up to approximately €250 million, and are often provided by a club of (mainly Dutch) banks on the basis of the LMA standards for investment grade or leveraged acquisition loans. For loans in excess of €250 million, larger syndicates often need to be formed. Given the limited number of sizeable Dutch banks active in the corporate lending market, non-Dutch banks are often required to be involved. Similarly, borrowers with foreign business or subsidiaries often try to engage banks from those jurisdictions as well.

Non-bank financing is also increasingly used but, certainly for sub-investment grade borrowers and corporate borrowers that are SMEs, still to a lesser extent. It particularly includes equity financing, debt capital markets financing, private placements, securitisations and financing by mezzanine debt funds.

II LEGAL AND REGULATORY DEVELOPMENTS

Since 1 July 2016, there have been no Dutch corporate law developments that have been particularly relevant for loan finance practice in the Netherlands. However, there have been regulatory changes that affect the position of lenders or borrowers in one way or another. Dutch regulatory developments from 1 July 2016 (other than through EU regulations) include the following:

a The Minister of Finance is considering a review of the Dutch Financial Markets Supervision Act in order to make financial regulation more accessible and future-proof. With a view thereto, the Minister published an exploratory study of options, offering five angles of approach that vary from leaving the Dutch Financial Markets Supervision Act as it is to replacement of that act with a number of separate, sectoral acts. The related consultation ran until 1 March 2017, and a response thereto from the Minister is expected to be presented to Parliament in the summer of 2017.

1 Jean-Marc Rovers is a senior associate and Jan Marten van Dijk is a partner at De Brauw Blackstone Westbroek.

b The Dutch Central Bank and the Netherlands Authority for the Financial Markets have jointly started an 'InnovationHub' aimed at providing a more accessible regulatory regime for existing and new innovative market parties in the financial sector by allowing direct contact between such market parties and regulators on financial services or products in development. In addition to such regulatory sandbox, an option for innovative financial institutions (which do not wish to engage in all operations governed by a full authorisation or are not able to meet all eligibility requirements yet) to apply for partial regulatory licences became available as of 1 January 2017.

c Following criticism from market parties, the Dutch Central Bank has published new factsheets with additional information about the screening process for prospective managing and supervisory directors of Dutch financial institutions. Also an external evaluation committee has been appointed to see if the current screening process is adequate.

d The Ministry of Finance has held a consultation on the Financial Markets Amendments Decree 2017 and the Financial Markets Amendment Bill 2018. These are expected to enter into force by 1 July 2017 and mid-2018, respectively.

III TAX CONSIDERATIONS

There is no withholding tax on interest in the Netherlands (except for subordinated loans with a maturity in excess of 50 years and profit-linked interest). Also, the Netherlands does not levy stamp duty.

For Dutch borrowers, interest on loans is tax deductible in principle. Exceptions to avoid abuse apply (including for 'sham loans' and loss financing loans with no realistic view of repayment). In addition, designated statutory restrictions may apply in specific circumstances, including:

a restrictions to avoid tax base erosion:
- resulting from equity or profit distributions, capital contributions or acquisitions (related party loans only);
- resulting from excessively leveraged investments in tax exempt participations; or
- resulting from excessively leveraged investments followed by a tax grouping, merger, demerger or liquidation; and

b including restrictions in relation to:
- subordinated loans with a maturity in excess of 50 years and profit-linked interest;
- related party loans with a term in excess of 10 years and a non-arm's length interest rate; and
- related party loans subject to such conditions that an independent party would not have accepted the credit risk under any circumstance.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Asset classes over which Dutch law security can be granted

Under Dutch law, security can be taken over real property, receivables (including trade receivables, intercompany loans, cash deposited in bank accounts and insurance receivables), inventory, intellectual property and certain other asset classes, such as shares in Dutch companies. Whether security can be taken over other asset classes will depend on the type of assets involved. A Dutch law security right can only be vested in assets that are transferable or assignable.

Types of Dutch law security

Dutch law provides for two types of security rights:

a security created on registered assets, such as real property, 'registered' vessels and aircraft and on limited rights vested therein, this type of security right being referred to as mortgage; and

b security created on all other assets, whether tangible (such as moveable assets) or intangible (such as receivables and registered shares), which type of security right is referred to as pledge.

The creation of Dutch law security

Security over the assets classes referred to above will be created as follows.

Dutch real property and other registered assets are mortgaged pursuant to a Dutch notarial deed and registration of the deed with the appropriate Dutch public register.

Trade receivables are pledged pursuant to a private deed and registration of the deed with the Dutch tax authorities (or pursuant to a notarial deed), without notification to the debtors of the receivables (an 'undisclosed pledge'). Such an undisclosed pledge over receivables constitutes a valid right of pledge (but can be invoked against the debtor of the receivable only after it has been notified to it). The pledge will attach only to receivables that exist at the date of the deed or that will be directly obtained from an agreement or other legal relationship existing at that date. To nonetheless maximise the security coverage, the practical solution is that in the deed of pledge the pledgor will agree to periodically (usually between one and three months, depending on the speed at which the trade receivables portfolio is renewed) enter into an additional deed of pledge. Pursuant to that additional deed, the pledgor will pledge the receivables existing at the date of the additional deed, or that will be directly obtained from a legal relationship existing at that date. Each additional deed of pledge must also be registered with the Dutch tax authorities. The original deed of pledge will set out the procedures to be followed (and grant any required powers of attorney) in connection with the signing and registration of each additional deed of pledge.

Dutch banks have implemented systems to further maximise their security coverage in relation to such trade or other receivables. Most Dutch banks pledge to themselves on a daily basis the receivables required to be pledged to them by way of a standardised deed covering all pledgors that have granted them a power of attorney to do so (as most will have done). The general validity of this system has been confirmed by case law from the Dutch Supreme Court.

Receivables can also be pledged pursuant to a private deed (or notarial deed) and notification of that deed to the debtors of the receivables (a 'disclosed pledge'). In practice, this type of creation of a pledge is reserved for specific types of receivables, including intercompany loans and insurance receivables. For legal reasons, cash deposited in bank accounts can be pledged only by way of a disclosed pledge. Generally, the pledgor shall not accept a disclosed pledge in respect of other receivables such as trade receivables, both to avoid the hassle of notifying large numbers of trade debtors of the pledge and to avoid trade debtors being made aware of the pledge through notification.

Dutch inventory is pledged pursuant to a private deed and registration of the deed with the Dutch tax authorities (or pursuant to a notarial deed). Such undisclosed pledge over inventory constitutes a valid right of pledge (but it may not be possible to invoke the pledge against a third party acting in good faith).

Although specific rules exist for specific types of intellectual property rights, as a general rule intellectual property rights are pledged pursuant to a private deed (but can also be pledged pursuant to a notarial deed). To ensure that the pledge can be invoked against third parties, for some intellectual property rights the pledge must be registered in the appropriate public registers. Because of the international character often attaching to intellectual property rights, creating security over intellectual property rights is rarely simple and cost-effective. Therefore, pledges on intellectual property rights tend to be the exception rather than the rule.

Shares in a Dutch private company with limited liability can be pledged pursuant to a Dutch notarial deed, unless the articles of association of the company provide otherwise. If the company concerned is not a party to the deed (which it usually will be) the pledgee can only invoke the pledge against the company if the pledge has been notified to it. The pledgee shall only have the right to vote, if so provided, whether or not subject to a condition precedent (such as the occurrence of an event of default), at the time of the creation of the right of pledge or thereafter agreed in writing and provided the transfer of the right to vote is approved by the general meeting. The articles may, however, derogate from these provisions. If the company has a works council, the works council may need to be given an opportunity to advise on the creation of the share pledge.

Registered shares in a Dutch public company that is not listed are pledged in largely the same way as described above, although formalities may differ depending on the company concerned. Pledges on other types of shares (such as bearer shares and shares included in a clearing system) are relatively rare in the context of loan financing. They are not discussed in this chapter.

Is it possible to give asset security by means of a general security agreement?

Separate pledges (or mortgages) must be created for the various types of assets such as Dutch real property, receivables, Dutch inventory, intellectual property and shares in Dutch companies. However, the various pledges can be combined in one deed of pledge. As a deed of mortgage on real property must be in notarial form and be registered in the Dutch public registers, such a deed will generally be a separate document from a deed of pledge over other asset types.

Formalities that need to be performed

Mortgages on Dutch real property must be registered in the appropriate public register, where the mortgage deeds are available for public inspection. Pledges on registered shares in a Dutch company must be notified to the company concerned, unless the company is a party to the deed of pledge (which would be the normal situation). The company must register the share pledge in its shareholders register, but the latter generally has no bearing on the validity or enforceability of the share pledge. The shareholders register is not open to public inspection. Undisclosed pledges on receivables and on Dutch inventory (including any supplemental deeds) must be registered with the Dutch tax authorities (unless they are in the form of a Dutch notarial deed). The purpose of the registration is to ensure that the pledge has an officially recorded date and not to facilitate levying taxes. Disclosed pledges on cash in a bank account, intercompany loans or insurance receivables need to be notified to the debtor or debtors concerned. No registration requirements apply. Pledges on intellectual property rights generally do not need to be registered in order to be valid. However, for some intellectual property rights registered in a public register (including patents, trade and service marks and models), the pledgor can only invoke the pledge against third parties if the pledge is registered in the appropriate register.

Payable fees

No registration involves significant amounts of time or expense. The costs of notarial work required in connection with mortgages on Dutch real property and pledges on will usually be charged as part of the legal fees. They are not dependent on the value of the underlying assets. Registration of mortgages with the appropriate public registers and of pledges with the Dutch tax authorities requires payment of nominal registration fees. For the purpose of the registration (if any) of pledges on intellectual property rights, it will often be necessary to involve a registration agency that will charge limited fees. In addition, nominal registration fees must be paid.

Enforcement of Dutch law security

A Dutch mortgage or pledge can only be enforced in case of a payment default under the secured obligations. However, in the case of a disclosed pledge on receivables, subject to any limitations agreed between the pledgor and the pledgee, the pledgee may at any time exercise the right to collect the receivable, and may apply the proceeds towards satisfaction of the secured obligations as soon as they are due and payable. The same applies in the case of an undisclosed pledge of receivables, except that in that case the debtor under the receivable must first be notified of the pledge. The moment as of which the pledgee becomes entitled to disclose the pledge is generally agreed in the deed of pledge.

In practice, undisclosed pledges on receivables are enforced by the pledgee first giving notice of the pledge to the debtors of the receivables and then collecting the receivables, while disclosed pledges on receivables are enforced by the pledgee giving notice of enforcement of the pledge to the debtors of the receivables and then collecting the receivables.

In case of an undisclosed pledge over inventory, again subject to any limitations agreed between the pledgor and the pledgee, the pledgee may take control of the pledged property if the pledgor or debtor does not, or if the pledgee has good reasons to fear that the pledgor or debtor will not meet its obligations. The deed of pledge may provide that the pledgee will have this right at an earlier or later stage.

Pledges on inventory are (and pledges on receivables may also be) enforced by way of a public sale. The sale requires compliance with certain procedural requirements. As an alternative, the pledgee (as well as the pledgor, unless otherwise agreed in the deed of pledge) may request the competent court to approve a private sale or to determine that the assets shall accrue to the pledgee. After a payment default under the secured obligations has occurred, the pledgor and the pledgee may also agree on an alternative manner to enforce the pledge (such as the assets accruing to the pledgee without court approval).

Mortgages on Dutch real property are enforced by way of a public sale. The sale requires compliance with certain procedural requirements that may be time-consuming. The mortgagee and the mortgagor may request that the competent court approve a private sale of the property.

Pledges on registered shares in a Dutch company are enforced in the manner set out for pledges on inventory. However, any transfer restrictions in the relevant company's articles of association must be complied with, provided that for private companies with limited liability the pledgee may exercise all rights vested in the shareholder with regard to such transfer and perform the latter's obligations in respect thereof.

A pledge on intellectual property rights is in principle enforced through sale of such rights in the same way as described above for inventory (and receivables). For certain intellectual property rights, however, specific rules apply, requiring, for example, the involvement of a civil law notary and imposing specific procedural rules.

Security created in favour of multiple creditors

The prevailing view is that Dutch law does not facilitate the granting of security on Dutch assets to more than one secured party by way of trust structures. For that reason, in almost every syndicated financing including security interests governed by Dutch law, a 'parallel debt' structure is used. Under that structure, each obligor undertakes to pay to the security agent in its own name (and not as the finance parties' representative) amounts equal to the amounts owed by that obligor to all lenders under the finance documents (that undertaking being the parallel debt). Dutch security interests are then created in the name of the security agent only (and thus not also in the name of the other finance parties) to secure the payment of the parallel debt. Each finance party subsequently has a contractual claim against the security agent for payment of an amount which is determined under an intercreditor arrangement from the proceeds of the enforcement of the security interests.

ii Guarantees and other forms of credit support

There are many other forms of credit support available under Dutch law. Guarantees are commonly included in Dutch law-governed LMA-based (syndicated) credit facilities. The wording, with a few exceptions, generally follows the LMA English law standards. Technical changes often agreed are mainly made to ensure that the guarantee is not to be considered as a suretyship or joint and several liability. To avoid a situation – which will usually only occur if the group is in distress – where a guarantor that has not benefited from the facility but has made a payment to the finance parties under its guarantee, and cannot take recourse against the borrower whose debts it has serviced, it is (from a guarantor's perspective) advisable to create a specific arrangement on recourse between obligors. There are various options available, but whichever alternative is chosen, recourse claims between obligors generally have limited practical relevance as long as the finance parties are not fully paid, as an LMA-based guarantee typically requires the obligors to refrain from exercising any recourse rights for as long as any amount under the facility agreement remains outstanding.

To a lesser extent, joint and several liability is assumed by obligors under Dutch law syndicated financings. That is often the case in the context of ancillary agreements relating to, for instance, cash management. In such event, the creditor is entitled to claim payment in full from each obligor. In the event that an obligor pays a greater share than required, that obligor is, for that greater share, entitled to take recourse against the other obligors who paid less than they are required to in their relation to the paying obligor. Such obligor shall be subrogated for such excess against the co-obligors and third parties, in each case up to the share of the co-obligor or third party in accordance with the relationship with that obligor.

Also, contractually a form of credit support can be created. That can, for instance, be done by agreeing to (extensive) negative undertakings limiting various activities that the borrower may not engage in without the lender's consent (as is common in the vast majority of financings in the Dutch market (including LMA-based financings)). In essence, such negative undertakings contractually enhance the risk profile of the borrower towards the finance parties. Examples of those undertakings are negative pledge undertakings that are routinely included in any credit facility and which also restrict the entering into of quasi-security (such as sale and leaseback transactions) and, although more common in leveraged transactions, covenants preventing dividend and other shareholder payments, which lenders will require to ensure that there is no 'cash leakage' from the borrower's group.

iii Priorities and subordination

In principle, creditors of Dutch debtors have, among themselves, an equal right to be paid from the net proceeds of all assets of their debtor in proportion to their claims. Their claims thus rank *pari passu*. Dutch law, however, accepts the possibility of a first ranking security right, second ranking security right, etc. with respect to both mortgage and pledge, and provides for other grounds for preference (such as rights of retention and privileges of the Dutch tax authority and a trustee in bankruptcy). Similarly, a contractual arrangement between a creditor and a debtor may stipulate that a claim of a creditor shall take, in respect of all or certain other creditors, a ranking lower than that conferred by law.

Priorities

Under Dutch law, as a general rule security which was created first in time has the highest priority. With respect to yet 'invisible' security rights (such as an undisclosed pledge on receivables) it is, therefore, important that conclusive evidence can be provided as to the date when a security right was created. Such evidence is provided through the execution of a pledge in the form of a notarial deed or by registration of a private deed with the Dutch tax authorities.

In the Netherlands, no public register exists in which pledges can be filed. As a result, there is no public basis on which a creditor can verify whether any assets of a debtor are encumbered with a pledge. Therefore, a creditor cannot determine in advance whether its debtor's assets have been pledged previously. However, mortgages are registered in a public register and thus their ranking can be determined by checking the appropriate register. Pledges on shares in a company are required to be recorded in that company's shareholder register. It is, however, to be noted that such shareholder registers are often incomplete and do not provide conclusive evidence.

Subordination

Subordination can arise directly from the law or may be agreed upon contractually between parties. An example of a subordination arising from the law is a subordination of claims of the shareholders of a company to the claims of other creditors of the company. More relevant for Dutch financing practice are forms of subordination contractually agreed as part of intercreditor arrangements. In determining the scope of a contractual subordination, the wording of the subordination clause or clauses is important, specifically to determine whether it will have an effect inside bankruptcy, outside bankruptcy or both.

Contractual subordination can be distinguished in statutory subordination and non-statutory subordination. Non-statutory subordination has effect only outside bankruptcy and comes in many varieties. In case of such non-statutory subordination, the subordination may, for example:

a relate to the ability to claim on certain obligations or to the right to claim itself (and thus does not need to be limited to rank only);

b ensure that a claim of the subordinated creditor only becomes due if the senior has been paid; or

c restrict the recourse rights of the subordinated creditor to certain assets of the debtor.

In the event of statutory subordination, the debtor and creditor can, however, only contractually agree that the claim of the creditor against the debtor will be subordinated in rank to all or certain other creditors of the debtor. This specific type of subordination is laid down in the Dutch Civil Code and, necessarily, applies only in case of insolvency (but may be combined with non-statutory subordination that applies outside insolvency). It also applies accordingly in cases of other types of concursus, particularly in the event of enforcement of security rights or attachments.

In order to invoke a statutory or non-statutory subordination against a debtor (in particular to prevent that such debtor can discharge its payment obligation towards the junior creditor), a subordination agreement needs to have been entered into between the junior creditor and the debtor. From a senior creditor point of view, it is preferable that it is a party to such agreement as well. Depending on the terms agreed in a subordination agreement (such as a full subordination towards all creditors), senior creditors that were not a party to such subordination agreement may nevertheless rely on such subordination.

A variation on the subordination described above is a type of (non-actual) subordination to which a debtor is not a party. As part thereof, it may be agreed, for instance, to not enforce certain rights or to agree on a waterfall. Such agreement cannot be invoked against the debtor and only affects the creditors that are a party thereto.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Banks entering into a financing documented in LMA form (whether bilateral or syndicated) routinely require that legal opinions are provided to them. If multiple jurisdictions are involved (for instance if the financing has foreign obligors), opinions from each relevant jurisdiction will be required. Customarily, opinions will be provided by counsel to the banks, although in some case banks may accept an opinion from counsel to the borrower, or agree to a split between a capacity opinion (to be provided by counsel to the borrower) and an enforceability opinion (to be provided by counsel to the banks).

Dutch opinion practice closely follows international and European practice. Dutch opinion givers tend to limit their opinions strictly to legal matters, and therefore tend to assume all facts that cannot be independently ascertained. For the same reason, Dutch opinion givers tend not to give 'no breach of agreements' and 'no violation of judgments' opinions, which are uncommon in the Dutch market.

VI LOAN TRADING

Most of the syndicated loans that are governed by Dutch law are documented using standard forms published by the LMA. LMA forms will typically also be utilised to document a transfer or assignment of commitments (at par or distressed) outstanding under any such Dutch law-governed syndicated credit facilities. Such credit facilities also provide to which financial entities commitments may be transferred and to what extent consent from the borrower (and within which time frame) may be required. For Dutch law-governed investment grade credit facilities, it is often agreed that for each assignment or transfer the borrower's consent is required unless the assignment or transfer is to another lender or its affiliate or an event of default is continuing. In more leveraged situations, the lenders are generally allowed to more freely assign or transfer any loan commitments and with less consent requirement being applicable. The cooperation of a Dutch borrower with a transfer or assignment may also be needed if know-your-client rules require investigation of the obligors, and because the borrower will need to countersign the transfer or assignment agreement.

Section II, *supra* explains certain regulatory restrictions as to the transfer or assignment of loans outstanding to Dutch borrowers. If the monetary threshold of (currently) €100,000 is not met (which hardly ever occurs in syndicated financings) and as long as no interpretation of 'public' within the meaning of CRD IV is available from competent European authority, a facility agreement to which a Dutch obligor is a party generally prescribes that the transferee or assignee then needs to confirm to each Dutch borrower that it nevertheless is not part of the 'public'. For most banks and other financial institutions, such confirmations should not be problematic to provide.

The parallel debt structure briefly described in Section IV, *supra* also facilitates secured loan transfers. That is because security interests created in favour of the security agent on the basis of a parallel debt will continue to secure the participation of the new lender in such secured loan following any transfer or assignment, and does not require any further documentation to be entered into or formalities to be completed.

VII OUTLOOK AND CONCLUSIONS

In the current climate of increasing economic growth in the Netherlands, Dutch banks have become increasingly eager to participate in new corporate and acquisition loans. In a low interest rate environment, banks' funding costs have substantially decreased and banks are now able to lend at more competitive rates. That having been said, as a result of the implementation of CRD IV and CRR in Dutch law, as is the case almost everywhere in the EU, Dutch banks are being required to hold more capital and of a higher quality for their risk-weighted assets (and the Basel Committee is currently working on new proposals that may further lift the banks' capital requirements – in particular for those banks that have a significant exposure to the Dutch mortgage market). That has also led to a gradual shift towards alternative ways of financing for corporate borrowers that need longer-term funding, have a higher-risk profile or require big-ticket loans. Alternative ways of financing accessible to medium-sized and large companies include financings by (pension) funds and insurers, private placements, securitisations and bonds issues. For longer-term financing, corporate bonds, USPPs, German Schuldscheins and other private placements have proven to be a viable alternative to bank financing. Similarly, investors with a longer-term investment horizon (such as pension funds and insurers typically have) will likely continue to participate in loan financings that mature beyond five years (as, for instance, is often the case in public private partnership financings).

The way that Dutch banks handle the new competition in the corporate finance market, and adapt to the new regulatory requirements and their impact on their appetite for new lending as well as funding needs of corporate borrowers, a potential future decrease of the ECB's quantative easing and macroeconomic developments generally, will determine lending and secured finance volumes and margins in the Dutch market for the near future. A prospect of even lower or negative interest rates may also force banks to seek out riskier lending opportunities to compensate for losses on their interest rate margins. That may also further lower the cost of borrowing for riskier companies in the Netherlands. It, therefore, is fair to say that the Dutch loan finance market will remain a market in motion, in which banks nevertheless are still expected to retain a dominant position.

Chapter 18

PORTUGAL

Pedro Cassiano Santos and Ricardo Seabra Moura[1]

I OVERVIEW

After several years of deep recession, following the bail-out programme back in 2011 between the Portuguese government and the European Union, the European Central Bank and the International Monetary Fund, and despite a number of noteworthy international events that could have important repercussions on the international markets, the Portuguese economy registered a clear growth trend over the past year and a half, and matters seen to have improved significantly in our jurisdiction. While the impact of such international events remains to be seen, the Portuguese corporate lending landscape has picked up during such period, and the number of lending transactions reflects the increase in consumer and company confidence level for years to come.

The past year has also been marked by several key strategic developments within the Portuguese banking sector. In line with past years, the regulatory constraints stemming from the increase of capital requirements, the European Central Bank (ECB) directives, the application of state aid rules to state recapitalisation procedures and the lack of available private capital to invest in share capital, have paved the way for a clear tendency towards a high concentration of the credit institutions that remain active in the Portuguese market. This trajectory contrasts with the fact that foreign banks are becoming more active in the Portuguese market, through the establishment of new branches and on a free movement of services and establishments basis.

With the application of a resolution measure to Banco Espírito Santo (BES) back in 2014, the main part of its assets, rights and liabilities were transferred to Novo Banco, SA (Novo Banco), a bridge bank set up by such resolution measure. The Bank of Portugal (BoP) is currently conducting a sale process of Novo Banco and in the first half of 2017 announced that a share purchase and subscription agreement relating to the share capital of Novo Banco was entered into between the Resolution Fund and Lone Star Fund, which is currently pending completion on compliance with several conditions precedent. While it is ultimately impossible to anticipate the final outcome of this sale procedure, it is at this stage possible to state that decisive steps have been taken towards its completion. Also on the banking resolution front, attention is also drawn to the application of another resolution measure to Banif, with the immediate sale of its assets and liabilities to Santander, following a decision of the BoP. The Banif resolution distinguished three separate lots within the former bank: the first corresponding to ongoing clientele and banking business, which was promptly sold

1 Pedro Cassiano Santos is a partner and Ricardo Seabra Moura is a managing associate at VdA Vieira de Almeida.

to Santander; the second through the creation of a special entity named Oitante, comprising most of the real estate and non-core businesses, to manage asset disposals and to attempt to maximise liquidation proceeds; and the third having residual nature for equity, subordinated positions and related party entitlements to be paid if and when the proceeds so permit. Furthermore, relevant events also include Spanish bank CaixaBank's takeover bid of BPI (it already being a major shareholder of BPI) and the acquisition by the Spanish bank Bankinter of Barclays' retail, private and corporate banking, and life insurance segments, and the opening of its first branch in Portugal. Similarly, the also Spain-based WiZink Bank acquired the credit cards business belonging to Barclays Bank (which, in turn, belonged previously to Citibank), yet again showing that there is always appetite for a business in this segment.

During this period, credit and financial institutions have continued their efforts to deleverage and to clear their balance sheets by selling loan portfolios or participations, in the context of not only syndicated loans, but also their internal restructuring processes. In fact, the significant amount of non-performing portfolios (NPL) currently on Portuguese banks' balance sheets paves the way for important transactions for the acquisition of such portfolios. On the other hand, shadow and off-balance-sheet banking through private equity, asset managers and insurance companies also registered a relevant increase, calling upon the many market investors to pay attention to this particularly interest market segment.

Among the most relevant corporate lending transactions we would highlight the financing of several shopping centres (Arrábida Shopping, NorteShopping and Style Outlets).

We draw particular the attention to the regular usage of the bond issue method as an alternative to the traditional lending activity based on individual loan agreements. This method has the advantage of enabling a swifter transfer and secondary placement of creditor loan participations, without the need for contractual amendments and avoiding impacts on the comprehensive security packages existing in these transactions, as they are granted on day one in favour of the security agent acting on behalf of the noteholders, whomever they may be at a given moment in time. This more flexible framework also benefits from the appointment of a common representative (a trustee-like arrangement where the entity appointed for these tasks represents noteholders in the creation and also, when applicable, in the enforcement of the security package) and enjoys a non-withholding status on interest payments made to non-resident lenders or investors since it clears in the Portuguese domestic clearing system, Interbolsa.

Usage of Loan Market Association terms is not that common within the Portuguese jurisdiction, but these are often used as a reference when drafting corporate lending agreements and security provisions, and the above-mentioned bond issuances have also accommodated this format.

Finally, as regards new loan trends, and in addition to the improvements registered on debt capital markets, although peer-to-peer lending is yet to be more specifically regulated in Portugal, this solution for credit disintermediation can already be found on the Portuguese market, with the emergence of some platforms over the past year. Despite its relatively small weight in the lending market, at present the peer-to-peer lending market appears to be registering an upward growth trend, especially for small and medium-sized enterprises. However, future regulation and the possible resulting costs for operators may have an impact on the evolution of this new credit trend, which is gaining traction throughout several Member States. In any event, for the time being loan financing remains an activity highly concentrated in banks.

II LEGAL AND REGULATORY DEVELOPMENTS

The past year was marked by intense legislative developments (mostly for implementation of European directives and also for clarification of existing banking laws), with the entry into force of several important laws and regulations that have rendered the lending market ever more densely regulated.

The legislative developments that had the strongest impact on the Portuguese lending market during the course of the past year are set forth below.

i Capital conservation buffers

As part of the implementation of the Basel III framework, adopted with adjustments at the European Union level through Directive No. 2013/36/EU of 26 June 2013 and Commission Regulation (EC) No. 575/2013 of 26 June 2013,[2] capital buffer provisions were implemented in Portugal at the end of 2014 by adding a new Title to the Portuguese Banking Law (the Banking Law). These capital buffers accrue to other capital requirements, and need to be met with highest quality capital.

The first capital buffer foreseen therein is the capital conservation buffer, set forth for general preventive purposes and corresponding to 2.5 per cent of the total risk exposure amount, on an individual and consolidated basis, as applicable. Under said legal framework, institutions failing to fulfil capital buffers must submit a capital conservation plan to the BoP.

Although there was legal leeway for a longer transitional period, the BoP decided, under the terms of Notice 1/2015 of 7 September, to anticipate its entry into force, to the beginning of January 2016, to promote the strengthening of solvency levels and the higher resilience of the financial system. However bearing in mind, on the one hand, that in the current context of the single supervisory mechanism the capital decisions related to credit companies are pre-launched and adopted for the whole euro area and, on the other hand, that any capitalisation operations arising from such decisions must be essentially made resorting to the market, Notice No. 1/2015 was recently revoked by Notice No. 6/2016, of 31 May 2016. Consequently, according to Notice No. 6/2016, the transitional regime established by Article 23, Nos. 1 to 4, of Decree-Law No. 157/2014 of 24 October, is applicable for capital conservation and countercyclical buffers, from 1 January 2016 to 31 December 2018, and, therefore, phasing-in details are: (1) for capital conservation buffer: 0.625 per cent in 2016, 1.25 per cent in 2017 and 1.875 per cent in 2018; and (2) for countercyclical buffer: a maximum 0.625 per cent in 2016, a maximum 1.25 per cent in 2017 and a maximum 1.875 per cent in 2018.

ii Negative interest rates

The recent past has also seen noteworthy developments concerning the application of negative interest rates within both the consumer and the corporate lending markets.

In March 2015, the BoP issued guideline No. 26/2015/DSC, addressing the impact of negative Euribor rates on existing finance agreements where the interest rate is calculated based on Euribor (the CL 26/2015). Briefly, the CL 26/2015 establishes that: (1) in the case of existing financing agreements that do not include a specific clause addressing a negative Euribor scenario, credit institutions shall not construe any clause as implicitly entitling them to limit the effects of negative Euribor rates; (2) in the case of agreements entered into after

2 CRD IV and CRR, respectively (the Capital Requirements Directive and Regulation).

that date, credit institutions are prohibited from introducing any floors in agreements with clients, with a view to limiting the effects of negative Euribor in the contractual interest rate; (3) nonetheless, credit institutions and their respective counterparties under the agreements are allowed to take certain (not defined in detail) precautionary measures to manage the risk of negative Euribor. Attention is drawn to the fact that despite the non-mandatory nature of BoP guidelines, they are generally followed by all regulated credit and financial entities, including in relation to all credit and financing agreements with consumers or other banking customers, such as mortgage loans, financial leasing and factoring, and are also likely to influence the decisions of courts.

Both legislative procedures for draft legal bills on: (1) prohibiting credit institutions from unilaterally amending the contractual terms or interest rates of financing agreements and deposits; and (2) compelling credit institutions to fully apply overall negative interest rates with respect to housing and consumer credit have been halted during the past months following declarations by the BoP's governor against the aforementioned draft legal bills and recommending the adoption of legislation mandatorily setting out a zero interest rate floor. A new draft legal bill aimed at clarifying this legal matter is still pending, so this issue will continue to be in the spotlight, and the next couple of months will be crucial so as to determine how this legislative process will unfold, but it now seems to be more likely that the zero interest rate floor will hold.

iii Implementation of the Transparency Directive

Directive No. 2013/50/EU on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (the Transparency Law) was implemented into Portuguese law by Decree-Law No. 22/2016 of 3 June. With the enactment of the Transparency Law, several amendments were made to the Securities Code with the aim of introducing greater flexibility. Among its key features, we would highlight the following: (1) overall loosening of language requirement rules, thereby allowing for a greater margin of acceptance of the English language; (2) elimination of the quarterly information disclosure requirement, with the exception of financial companies; (3) economic long positions become part of qualified shareholdings; and (4) regarding public offers, the previous reference to 150 targeted residents in Portugal was replaced by 150 residents per Member State.

Prohibition of the issue of bearer securities

Following the approval of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015, Portugal has recently enacted Law No. 15/2017, of 3 May, which prohibits the issuance of bearer securities. With the entry into force of this law, several articles of the Portuguese Companies Code and the Portuguese Securities Code that regulate bearer securities have been amended.

With the approval of the above-mentioned Law, whose fundamental aim consists of enhancing transparency and, thereby, contributing to preventing money laundering or terrorist financing activities, it will no longer be possible to issue bearer securities in Portugal, while existing bearer securities will need to be converted into nominal securities within a six-month deadline of the entry into force of this law.

Failure to convert bearer securities into nominal securities during the prescribed period will determine the application, as from 4 November 2017, of a transfer prohibition, as well as of the suspension of the right to dividends, in the case of shares, and interest, in the case of bonds.

Furthermore, a decree-law has also been approved with regards to this prohibition, with the objective of ensuring the articulation between Law No. 15/2017 and the legislation specifically applicable to public debt, allowing for the continuity of issues under the General Public Debt Issuance and Management Regime.

v Credit intermediaries and consultancy services in the field of credit agreements

A bill regulating the activity of credit intermediation and the provision of consultancy services in the scope of credit agreements has been approved by the Portuguese parliament and is currently pending enactment at government level. This bill implements Directive 2014/17/EU of the European Parliament and of the Council of 4 February and authorises the government to approve a legal framework applicable to the activity of credit intermediaries and the provision to consumers of consultancy services in the field of credit agreements. Such legal framework shall include rules on access and exercise of such activity, which will also include probity and qualifications control rules and its sanctions framework.

vi Credit agreements for consumers relating to immoveable property

Decree-Law No. 74-A/2017, of 23 June 2017, approved the legal framework on credit agreements for consumers relating to immoveable property, establishing in particular the rules applicable to consumer credit guaranteed by mortgage or another right over immoveable property, partially transposing Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immoveable property and amending the regime on credit agreements for consumers (Decree-Law No. 133/2009, of 2 June 2009).

Despite the fact that Directive 2014/17/EU regulates credit agreements that solely or predominantly relate to residential immoveable property, Decree-Law No. 74-A/2017 also regulates credit secured by immoveable property regardless of the residential purpose of the credit and consolidates in a single legislative act the various rights granted to consumers in the field of mortgage credit.

The new regime strengthens the provisions relating to the assessment of the consumer's ability to repay the secured credit (in comparison with other types of consumer credit), as well as the assurances that the consumer is able to make a rational and informed decision on the characteristics of the credit to be executed. In addition, considering the frequency with which the Portuguese mortgage market uses personal guarantees, this protection also extends to the consumer who acts as personal guarantor – and who also makes a financial commitment. Given the importance of the transaction, it is ensured that consumers have sufficient time to consider the implications of contracting credit or granting personal guarantees.

vii Transposition of Directive 2014/65/EU and implementation of Regulation (EU) No. 600/2014

The National Council of Financial Supervisors (*Conselho Nacional de Supervisores Financeiros*) has launched a public consultation on a preliminary draft for the implementation of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID II) and the implementation of Regulation (EU)

No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID), amending, *inter alia*, the Portuguese Securities Code and the Legal Framework of Credit Institutions and Financial Companies.

In this context, it should be noted that the preliminary draft limits the list of instruments considered as non-complex for purposes of the 'mere execution' of orders established in Article 314-D of the Portuguese Securities Code and stipulates that, for the purpose of benefiting from the 'mere execution' regime, the exclusive provision of services of reception and transmission or execution of customer orders cannot be accompanied by the provision of an associate service of credit concession to support transactions in financial instruments, without prejudice to certain credit facilities granted for other purposes that are not tantamount to carrying out of financial instrument transactions.

III TAX CONSIDERATIONS

In Portugal, two different but complementary taxes with an impact on loan transactions are to be mentioned and properly considered: (1) withholding of tax on interest payments; and (2) stamp duty on loans, guarantees and, when applicable, also on interests and financial commissions.

i *Portuguese withholding taxes*

Payments of interest made by Portuguese tax-resident entities to non-resident entities are, as a general rule, subject to a final Portuguese withholding tax rate of 25 per cent, which may be reduced to as low as 5 per cent depending on the applicable double tax treaty (DTT) signed between Portugal and the other relevant contracting state. As an exception, the DTT between Portugal and the United States provides for a full withholding relief on long-term loans (of five or more years) when granted by US-resident banks or financial institutions, and when other formalities are complied with. Other withholding tax exemptions arise from European and domestic tax legislation. Related companies within EU countries, when the other legal requirements and formalities are met, will also benefit from the Portuguese withholding tax exemption under the Interest and Royalties Directive. When the lender is a non-resident bank or financial institution, specific withholding tax exemptions are available, such as: (1) interest payments on loans made by Portuguese-resident credit institutions; and (2) interest derived from long-term deposits in Portugal when paid to non-resident credit institutions.

Regarding payments of interest by resident entities, the aforementioned general rate also applies except when the beneficiaries are Portuguese financial institutions. In this regard, the European Court of Justice (the *Brisal* case – C-18/15) has stated that there is a discriminatory tax treatment regarding payments of interest made by Portuguese corporate entities (not qualified as financial institutions) to non-resident financial institutions (subject to Portuguese withholding tax) when compared with resident ones (withholding tax waiver applies) under EU law. It is expected there will be an amendment to the Portuguese tax law in order to reflect such Court decision.

Apart from classic loans, interest payments made by Portuguese issuers to non-resident investors regarding bonds and securitisation transactions (when integrated in Interbolsa, Clearstream or Euroclear) will also be exempt from income tax under the requirements set forth in Decree Law 193/2005, of 7 November 2005, as amended.

ii Tax deductibility

As a general rule, interest payments on any sort of funding are tax-deductible. Portugal created an interest restriction rule to limit the deductibility of net financial expenses to the higher of the following: (1) €1 million, or (2) 30 per cent of the earnings before interest, taxes, depreciation and amortisation. Net financial costs that are not deductible in any fiscal year, as a result of the limits just detailed, may be carried forward for a period of five fiscal years, as long as the established limits are complied with. When the current net financial expenses in a year are below the barrier pursuant to the 30 per cent rule, the difference can be carried forward and added to the 30 per cent limit for the purpose of deducting net financial expenses in the following five fiscal years. Among other entities, entities subject to the supervision of the BoP (the Portuguese central bank), to the Portuguese Insurance and Pension Funds Supervisory Authority and branches of foreign financial institutions and insurance companies located in Portugal are beyond the scope of the rule. In any case, transfer pricing rules need to be observed between related parties otherwise interest may not be fully tax-deductible.

iii Stamp tax

The stamp tax rate on loans and guarantees is 0.04 per cent per month or fraction on transactions with a maturity of less than 12 months or represents a lump sum payment of 0.5 per cent. This rate is even increased to 0.6 per cent on transactions with maturity in excess of five years. The tax is levied on the amount of the loan granted and on the secured obligations amount.[3] Current accounts or overdrafts are subject to 0.04 per cent tax rate on the monthly average of the total daily debtor balances, during the month, divided by 30. Interest and commissions payments are subject to a 4 per cent stamp tax over the amount paid only when charged by financial institutions. However, no stamp tax shall be payable in Portugal on loan transactions and on related interest, commissions payments and guarantees granted between financial institutions provided they are not domiciled in a blacklisted jurisdiction.

On the other hand, stamp tax will not be applicable at all in connection with the issue or distribution of debt securities (either bonds or securitisations) and on related interest payments.

iv Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS)

In August 2015, Portugal and the United States signed an intergovernmental agreement (IGA Model 1A), to implement FATCA. The IGA between Portugal and the United States is currently in force. Furthermore, domestic complementary legislation and specific reporting forms have been created in this respect.

Based on FATCA, the Organisation for Economic Co-operation and Development (OECD) created the CRS, according to which jurisdictions obtain information on financial accounts and income (including on interest) from their financial institutions, which will be automatically exchanged with other jurisdictions on an annual basis. Therefore, Portuguese financial institutions will initiate the reporting in 2017 regarding 2016 tax period being such information exchanged with other jurisdictions.

3 No stamp tax will be levied on guarantees and security interests that are deemed materially accessory and are granted simultaneously to any obligations that were effectively subject to stamp tax.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Financing operations governed by Portuguese law are very often secured by guarantees over the assets of the debtor or of third parties to the benefit of the creditor. Such guarantees are usually divided into the following two main groups: (1) personal guarantees, which entitle the beneficiary, in the event of default of an obligation, to be paid from the assets of third parties further to the assets of the debtor; or (2) security interests, which entitle the beneficiary to be paid from the value or revenues of certain and specified property or assets of the debtor or third parties.

Security is provided over different types of assets, in particular over real estate, shares, tangible moveable property, financial instruments, contractual rights and intellectual property rights. Pledges and mortgages (*in rem* rights created over moveable and immoveable assets respectively) remain the most commonly created security interests within the corporate lending market.

Attention is drawn to the advantages of applying the financial pledge legal framework, which has the key feature of not requiring judicial enforcement, thereby conferring the right to unilaterally perform out-of-court enforcement, which the pledgor cannot oppose. However, the enforcement of a financial pledge may require the granting of an irrevocable power of attorney subject to public deed, which constitutes a very effective mechanism to ensure compliance and full execution by the pledgor of its obligations. Additionally, a financial pledge, in contrast to an ordinary pledge, allows the pledgee to retain the pledged assets in a foreclosure scenario, when the security is enforced.

Applicable regulatory requirements (notably, registration or authorisation) are usually complied with by the security provider and not by its eventual beneficiary, unless expressly provided otherwise by the parties to a security agreement. While registration involves some costs, the biggest costs for registering a security will stem from stamp duty payment, levied over the secured amount. And, while perfection requirements may apply so as to ensure their valid creation, no action is required to reserve the validity of security interests, which shall remain valid until the secured obligations have been discharged in full.

Several asset types present greater challenges in creating effective security, and this is the case with receivables. Although the constitution of a security over a receivable does not require the periodic production of lists of receivables subject to the pledge, it is highly advisable to take this with a view to ensuring ongoing monitoring of the outstanding receivables, thereby raising the costs of its maintenance. Security creation over inventory and moveables will present similar challenges. Special formalities will apply in the case of vehicles subject to mandatory registration – such as boats and aircraft – as well as to land and buildings, as the creation of mortgage over such assets will be required.

Among the limits applicable under Portuguese law to the creation of security we would highlight the general principle according to which security must be created over identifiable assets. Accordingly, the constitution of a floating security is not accepted. This principle is applicable to security interests and not to personal guarantees. Furthermore, while it is possible to create a promise to pledge, or a pledge aimed at securing conditional or future obligations, pledges of future property may not be created, seeing as this requires prior ownership over the asset in question.

ii Guarantees and other forms of credit support

The establishment of contractual restrictions, such as negative pledge undertakings or assignment restrictions, is usually demanded by creditors when entering into security agreements, so as to safeguard the asset given as security.

iii Priorities and subordination

Security interests (such as pledges and mortgages) will be ranked, taking into account the priority of their creation or registration (i.e., their creation date), whereas personal guarantees are generally not subject to ranking.

The same asset may be encumbered to the benefit of several lenders, enjoying a credit entitlement deriving from the same source (in which case, they can be ranked or positioned *pari passu*), or from different sources (in which case, one will be subordinated to others, unless otherwise agreed with the legally prior-ranking creditors).

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

In Portugal, the practice of issuing legal opinions is aligned with that of other jurisdictions. In a nutshell, the legal opinion dynamic varies slightly depending on the dimension of the transaction at issue. In fact, whereas in larger transactions, namely bond issuance transactions, the arranger and the issuer will each require a specific legal opinion from their own legal counsel, in the case of classic corporate lending transactions, only one legal opinion is generally issued, by the lender's legal counsel. In any case, in both scenarios such legal opinions are expected to specifically address matters concerning the capacity of the companies entering into the relevant agreement and its enforceability before the Portuguese courts. The disclosure of a legal opinion is almost always restricted to the counsel's client.

Some of the main issues lenders typically need to be made aware of, and which are particularly relevant in the context of acquisition financing transactions or group-wide financing transactions, are outlined below.

i Corporate benefit

Portuguese corporate law sets forth a corporate benefit requirement for the creation of personal guarantees or of security interests regarding the debt of third companies. Indeed, the creation by any given company of such a security or guarantee to the benefit of third companies will only be admitted if this action is performed in the justified own interest of that given company, or if it is provided to secure a debt incurred by a separate company with which the aforementioned company has a control or group relationship.

Compliance with the corporate benefit rule requires a certain degree of factual and circumstantial analysis, and, therefore, a case-by-case approach to this specific topic is highly advisable. For there to be adequate corporate benefit, several elements should be taken into consideration, such as the group structure and the nature of the operation at issue, but its fulfilment is generally not difficult to establish in the context of downstream or upstream group guarantees, as such cases will benefit from the exception applicable to guarantees provided to a company with which it has a control or group relationship.

Should there be any doubt as to the presence of adequate corporate benefit, seeking its shareholders' approval (preferably before the transaction is entered into, or even afterwards, with a view to ratifying the security creation) will certainly contribute to strengthening the security provider's position. For this reason, the demand for a corporate resolution represents a very common condition precedent in the Portuguese jurisdiction within the scope of lending transactions.

ii Financial assistance

Under Portuguese law, companies are prohibited from providing loans, funds or security to a third party with a view to the purchase of company shares representing its share capital. Nonetheless, while this financial assistance prohibition is clear in relation to the acquisition of shares, it does not apply to the acquisition of debt instruments or liabilities of said company. Despite the fact that there is some debate as to the application of this prohibition to limited companies, it is widely accepted that the rule is targeted at share companies and should only be considered in relation to these companies.

On the other hand, the financial assistance prohibition is not expressly targeted at the specific case of the grant of security or the provision of guarantees by subsidiaries for the acquisition of the parent company shares. In fact, despite the extension of the special own shares regime to subsidiaries, the extension is far from clear as regards the financial assistance provision. In any event, the Portuguese Companies Code has not yet been modified in light of Directive 2012/30/EU, which softened the financial assistance legal framework, including consideration of the aggregate financial assistance granted to third parties in the scope of financial assistance provided by subsidiaries, but this is naturally an interpretative element that should be considered in this regard.

iii Clawback

Clawback rules (*actio pauliana*) allow for the challenging of transactions that involve acts liable to be qualified as detrimental to the insolvency estate and that were motivated by bad faith. Creditors have the option, when confronted with such acts, of challenging the transaction in the scope of insolvency proceedings. The relevant acts for this purpose are those that diminish, frustrate, aggravate, put in danger or delay the rights of the debtor's creditors, thereby contributing towards the depletion of the insolvency estate.

Clawback rules allow the insolvency administrator to challenge acts or agreements considered detrimental to the insolvency estate, and that were executed within the two years preceding the commencement date of the relevant insolvency proceedings by sending notice to that effect to the counterparty to the agreement.

Bad faith, which must be established to apply this provision, is presumed in relation to acts taking place two years prior to the commencement of insolvency proceedings and in which the third party participated, or if the act resulted in a benefit to a person or entity especially connected to the insolvent company, even if a special relationship did not exist on the date of the act at issue.

Bad faith is defined as knowledge of any of the following circumstances: (1) the debtor's insolvency (i.e., inability to fulfil its obligations as they fell due); (2) that the act was of a detrimental nature and that the debtor was in a situation of imminent insolvency; or (3) that insolvency proceedings had already commenced. Certain acts and transactions are deemed to be detrimental to the insolvency estate without the need for any additional proof; for example, where: (1) security has been granted within a period of six months prior to the commencement of corporate insolvency proceedings (where the security was granted in respect of pre-existing obligations); or (2) gratuitous acts performed less than two years before the commencement of the corporate insolvency proceedings, resulting in a reduction in the assets of the debtor.

VI LOAN TRADING

Syndication remains widely used by lenders seeking to reduce their exposure in the context of a loan. In this context, lenders typically trade their participations using a contractual position assignment, credits assignment or subrogation.

All rights and obligations are transferred with the perfection of an assignment of contractual position, which remains the most common and straightforward method to trade a participation within a syndicated loan. Moreover, while contractual position assignment generally requires the consent of the other party, syndicated loan agreements usually establish that the lender's contractual position may be freely transferred without the need for the borrower's consent. In any event, no specific formalities are required to effect the assignment, and although notification to the borrower is not mandatory, it bears relevance for enforcement purposes.

Security is usually constituted to the benefit of a security agent, appointed by the lending syndicate precisely so as to avoid the need for additional formalities (namely with regards to registration) following the assignment of contractual position by a member of the lending syndicate.

The assignment of credits is used as an alternative method, particularly in cases where an assignment of contractual position would have an impact on security arrangements. However, this method does not entail the transfer of the lender's rights and obligations in relation to the borrower under the relevant syndicated loan agreement to the acquiring entity.

VII OUTLOOK AND CONCLUSIONS

The recovery and more stable development registered by the Portuguese economy over recent years, in the context of a stable EU macroeconomic scenario, could suggest a favourable outlook for the corporate lending market over the coming years.

The past years have seen several non-performing portfolios sales transactions, as Portuguese banks shifted from having wide balance sheets and positively went on a diet to focus on their core businesses. Furthermore, the improvement of the economic environment has been coupled with political stability as the current left-wing government fared much better than preliminary expectations. There is naturally an impact of the political landscape as international developments unfold, namely in the wider European context, in light of the agreement forged in Brexit negotiations. Inevitably we have to accept that political developments will have a significant effect on the corporate lending market, and ascertaining just what political contexts we will be facing – which of those we may cope with and which will require other types of responses – looks like becoming our biggest challenge.

From an economic perspective, the persistence of low interest rates will almost certainly continue to bear on the lending market, allowing for continued borrowing at favourable rates. Nonetheless, the real question in prospect is in ascertaining whether lenders willing to lend in these conditions will be found, and if not, what alternative locations lenders will find to ensure returns and a proper margin to stay profitable.

That said, the growing competition registered in the banking sector, the inevitable concentration of the market following the break-up of several competitors, by resolution and acquisition by other players, and the increasingly demanding capital and liquidity requirements have certainly been at the very centre of the important reorganisation processes Portuguese banks have had to undergo, are currently undergoing and will have to continue undergoing.

During the upcoming year, no significant legislative developments are expected to have a major impact on the Portuguese lending market and the legislative front seems to be rather stable. Nevertheless, the development of new sources of financing (as an alternative to classic bank lending) – using debt capital markets, or even like those taking advantage of the recent development of a legal framework for crowdfunding, as well as the possible future development of a similar framework for peer-to-peer lending – and the growing importance of these alternative sources is expected to remain of legislative concern in the near future.

There is, however, a clear certainty in this outlook: the ability of Portuguese credit and finance institutions to adapt to an ever denser and ever more demanding legislative and regulatory setting (particularly in light of the origin of such developments at EU and ECB level), and to adapt to increasingly demanding capital and liquidity requirements, will surely have an impact on their future prospects and on the evolution of the lending and secured finance market.

Chapter 19

SPAIN

Ángel Pérez López, Pedro Ravina Martín and Blanca Arlabán Gabeiras[1]

I OVERVIEW

Following years of financial turmoil, the Spanish economy has been recovering steadily. GDP growth exceeded expectations in 2016. Economic activity expanded by 3.2 per cent, well above the euro area average. As a result, the Spanish government has recently increased Spain's growth forecasts to 3 per cent for 2017 and 2.6 per cent for 2018. Yet, Spain, like other European Union Member States, faces both political and financial challenges in the near future. Deleveraging the private and public sectors and achieving higher productivity are still priorities. Although unemployment has significantly decreased since the crisis, at 17.7 per cent of the workforce, it remains one of the highest among the Western economies. Likewise, the vote of the UK to leave the European Union opens a door to unknown risks (and perhaps potential opportunities) that will need to be addressed in due course as the negotiations between the UK and the EU progress.

Spanish banks have benefited from Spain's economic recovery, as well as from access to liquidity and low funding costs, which have facilitated new lending activity. According to the surveillance visit to Spain carried out by the staff of the European Commission and the European Central Bank in April 2017, overall, the Spanish banking sector meets the regulatory capital requirements and the quality of the banks' assets has strengthened.

However, Spanish banks – like international banks – continue to be exposed to the consequences of Brexit, pressures of increasing regulation, low interest rates and increased competition. To tackle these challenges, further integration and measures to improve capitalisation are expected. A topical example is Banco Popular, which after several unsuccessful attempts to raise capital or sell the bank in the market, faced a liquidity crisis. On 7 June 2017, pursuant to the resolution scheme set forth in Regulation (EU) No. 806/2014 of 15 July 2014, the Single Resolution Board resolved to transfer Banco Popular to Banco Santander for the price of €1, after ordering the write-down of all existing shares (Common Equity 1) and the Additional Tier 1 instruments, and the conversion of its Tier 2 instruments into new shares. Likewise, the Fund for Orderly Bank Restructuring (FROB) has given the green light to the merger of two state-owned banks, Bankia and Banco Mare Nostrum.

Although the non-performing loan ratio has decreased, Spanish banks, including the Spanish 'bad bank' (SAREB), which holds the most distressed assets previously owned by the bailed-out institutions, have continued to be very active in selling loan portfolios and

1 Ángel Pérez López and Pedro Ravina Martín are partners and Blanca Arlabán Gabeiras is a senior associate at Uría Menéndez Abogados, SLP. The authors thank David López Pombo and Violeta Pina Montaner for their contribution to the tax section.

distressed real estate assets. In 2016 alone, banks sold portfolios with an outstanding value of more than €15 billion. A similar volume of NPL deals (if not higher) is expected in 2017, with a large number of assets from Banco Popular on sale.

Refinancing and restructuring transactions have continued to play an important role. Benefiting from the review of the Spanish insolvency law in 2014 and 2015, we have seen significant deals closed or still in process (among others, Abengoa, Isolux (now subject to insolvency proceedings), Cementos Portland Valderrivas and Codere).

Meanwhile, M&A activity and corporate lending have increased. According to Thomson Reuters, in 2016 the total volume of loans originated by Spanish banks was approximately €59.2 billion. Although this figure is lower than the previous year, the nature of the transactions differs, as several corporates have refinanced their respective debts to improve their financial terms. The most active sectors have been construction, energy and services. Amongst the largest corporate lending transactions, the following are worth noting: ACS (€2.35 billion), Acciona (€2.2 billion), Ferrovial (€1.25 billion), refinancing of Iberdrola (€2.5 billion) and Gestamp (€1.125 billion). Telefónica also undertook two refinancings of its debt (in the amount of €3 billion and €2.5 billion, respectively). Other companies that have been successful in negotiating improved terms are Metrovacesa, FCC and Merlín Properties, among others.

In 2015, a number of reforms were introduced by the government to stimulate the use of non-banking funding. Among other things, significant restrictions that had been part of the Spanish bond market for a very long time were removed and legal frameworks governing other sources of funding were significantly revised (securitisations) or introduced for the first time (crowdfunding). Since then we have seen a number of high-yield debt issuances by Spanish companies and the development of the Spanish debt market suitable mainly for small and medium-sized enterprises (SMEs).

II LEGAL AND REGULATORY DEVELOPMENTS

In recent years, one of the main aims of Spanish legislators has been to amend the Spanish insolvency law in order to introduce mechanisms that incentivise out-of-court restructuring and facilitate a fresh start both for companies and individuals. Groundbreaking amendments have been approved since 2012 in pursuit of this goal. Since then, the Spanish insolvency system has been gradually introducing tools that (1) allow companies to delay the insolvency filing for four months once they communicate to the courts that they are negotiating a composition or refinancing agreement with their creditors; (2) protect creditors from clawback risk if the refinancing agreements comply with certain requirements; and (3) facilitate the cramming down of dissenting creditors if the refinancing agreements obtain the sanction of the court (sometimes known as '*homologación judicial*'). Further technical amendments were approved in 2014 and 2015 in respect of refinancing agreements (including changes to the methodology for the valuation of secured claims to determine the part of the claim that can be subject to cramdown) and composition agreements (incorporating some principles already foreseen for the refinancing agreements).

A brand new set of rules was introduced to protect individuals, who having undergone an insolvency proceeding that has been completed, are unable to meet all outstanding liabilities. Under the new scheme, known as 'fresh start', subject to a number of conditions and formalities, the individual could be released from his or her outstanding liabilities. Likewise, a new regime applicable to out-of-court settlement for payments was enacted in

2015. This out-of-court mechanism allows individuals (including entrepreneurs) and small enterprises to apply for debt relief. The out-of-court settlement is based on the appointment of an insolvency 'mediator', who will convene a meeting between the debtor and its creditors with the aim of agreeing a revised repayment plan.

The above could be further modified in the short term if the proposal for a consolidated text of the Spanish Insolvency Law, which has been recently made by the Spanish General Codifying Commission, comes into force. This proposal has been criticised by some of the most reputed Spanish scholars, who understand that the Commission has exceeded its remit (the proposal not only provides for a consolidated text of the Spanish Insolvency Law, it also introduces some important amendments to the Spanish insolvency regime).

Meanwhile, at a European level, the progressive development of the legal framework applicable to credit entities has steadily continued. In 2014 and 2016, Spain transposed new European directives on the solvency, supervision, restructuring and resolution of credit entities. The Bank of Spain has recently published a draft bill to amend the accounting regime applicable to credit institutions, to implement IFRS 15 and 9. Both should take effect on 1 January 2018. These changes will require credit institutions to make provisions for expected impairments rather than actual impairments and is likely to have a significant impact on all banks. Furthermore, a new set of rules has also been approved to facilitate the restructuring of Spain's rural savings banks (*cajas rurales*), which represent approximately 6 per cent of the Spanish banking system and which are the last remaining unreformed institutions following the comprehensive restructuring of the Spanish banking sector undertaken since 2012.

Recent consumer-friendly court rulings present further challenges for Spanish banks. In December 2016, the European Court of Justice ruled that 'floor clauses' (clauses that set a minimum interest rate for Spanish mortgage contracts) were unfair to consumers. Controversially, the ruling was made with retroactive effect, and a significant volume of mortgage contracts executed prior to the ruling are affected. Similarly, the Spanish Supreme Court in its judgment of 23 December 2015 declared null and void the clauses that impose all the expenses of creation of mortgages to the client. This ruling has been followed by other courts and is also to have a significant impact on Spanish banks in the near future. An out-of-court complaint system has been created in order to reduce judicial costs for consumers and banks and to release the burden of an increasing number of claims from the administration of justice. Finally, it is expected that the mortgage law will be amended in the coming months to implement the provisions of Directive 2014/17/EU of 4 February 2014 on credit agreements for consumers relating to residential immoveable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010. A first draft of the new law has been published by the government.

III TAX CONSIDERATIONS

The main corporate tax chargeable on interest and other amounts receivable under a loan is corporation tax, which applies to the entire income obtained by the taxpayer. Interest received should therefore be included with all the other income generated by the lender. Interest must be included within the corporation tax base when accrued. The accrual principle for tax purposes follows International Financial Reporting Standards rules. The general corporation tax rate is 25 per cent (30 per cent for credit institutions).

Borrowing costs are deductible expenses for corporation tax purposes. Borrowing costs include interest of any kind, transaction costs and other similar expenses, and may be deducted when accrued. Nevertheless, tax deduction of interest is contingent upon some limitations, namely:

a Interest from participating loans in which the lender and the borrower are members of the same group of companies are not deductible.

b Interest from loans in which the lender and the borrower are members of the same group of companies are not deductible if the funds borrowed are used to buy shares, the seller being an entity who is also a member of the group of companies, unless the taxpayer proves that the transaction has valid economic reasons.

c Net interest that exceeds 30 per cent of the operating profit is not deductible. Net interest means the excess of financial expenses over financial income. Operating profit is calculated in a similar way to earnings before interest, tax, depreciation and amortisation. Net financial expenses that have not been deducted can be carried forward with no time limit, but are subject to the threshold of 30 per cent of the operating profit of each fiscal year. This limitation is not applicable to, *inter alia*, credit institutions or insurance companies.

d The deductibility of interest from loans used to acquire shares would be generally limited to 30 per cent of the EBIDTA of the acquiring company. However, this limitation should not apply: (1) in the tax year in which the acquisition is executed to the extent that the acquisition is financed with a maximum debt of 70 per cent of the acquisition price; and (2) in the following tax years, should the loan be reduced, proportionally, on an annual basis within the following eight years, until the debt is 30 per cent of the acquisition price.

Interest paid is generally subject to withholding tax at the rate of 19 per cent.

Withholding taxes applied on interest payments to taxpayers who are residents of Spain are refundable from the corporate tax of the recipient. In addition, some interest payments to Spanish residents are exempt from withholding tax, for instance:

a interest paid to entities that are exempt from corporation tax (e.g., the Kingdom of Spain, its political subdivisions and its administrative agencies, the Bank of Spain);

b loan interest paid to banks and some other financial institutions;

c loan interest paid to securitisation funds; and

d interest paid between entities belonging to the same tax consolidation group.

Withholding taxes levied on the payment of interest to taxpayers who are resident abroad are not refundable, but there are some exemptions from withholding tax:

a interest paid to European Union residents are exempt; and

b interest paid to non-EU residents who are residents in a double tax convention jurisdiction may, under the applicable convention, benefit from withholding tax reductions or exemptions.

The granting and negotiation of loans and credits as part of an economic activity is a supply of services subject to but exempt from value added tax. No other taxes are due upon the execution of a corporate loan.

Mortgages are subject to stamp duties ranging between 0.5 per cent and 1 per cent (depending on the Spanish region where the mortgaged asset is located) on the total amount (i.e., principal, interest, default interest, etc.) secured by the mortgage. It may, therefore, be the case that the total stamp duty ranges between 1 per cent and 1.4 per cent of the principal amount of the secured loan.

The assignment of loans or credits secured by a mortgage is generally subject to stamp duty, unless made in a private agreement (i.e., a document not having access to the Land Registry). This is why it is not uncommon in the Spanish market that mortgaged credits are assigned in private documents and notarised upon the borrower's default (hence when there is a need to enforce the mortgage).

In 2013, the United States and Spain entered into an intergovernmental agreement (IGA Model 1A) to provide for the implementation of the US legislation commonly known as the Foreign Account Tax Compliance Act (FATCA). FATCA requires financial institutions outside the US (FFIs) to report certain information on US account holders to the US tax authorities. If those FFIs fail to report the required information (non-participating FFIs), then a punitive 30 per cent tax would be withheld on, *inter alia*, their US source income.

The Loan Market Association (LMA) published and subsequently amended a template investment grade facility agreement, including FATCA provisions that are generally used in cross-border transactions and by Spanish lenders and borrowers. In summary, the FATCA provisions include:

a FATCA-defined terms;
b the obligation of providing FATCA information (that is, mainly, whether the parties are exempt from FATCA meaning they are not non-participating FFIs); and
c FATCA gross-up clauses.

The gross-up obligation varies depending on who should be protected from FATCA withholding. However, it is now market practice that borrowers should not make additional payments in the event of FATCA withholding because it only arises when the lender is a non-participating FFI, this is to say, the risk of FATCA withholding is essentially one that can be mitigated by the lender. In addition, when the transaction requires a paying agent, it is common to include provisions stating the resignation of the agent because of the risk of FATCA withholding when the agent becomes a non-participating FFI. Therefore, the practice in Spain does not differ substantially from that followed in other jurisdictions.

IV CREDIT SUPPORT AND SUBORDINATION

Financing transactions governed by Spanish law are frequently secured by security interests and guaranteed by personal guarantees that will generally only be enforced by the security agent (to avoid partial foreclosures by any creditor). As the legal concept of the security trust does not exist under Spanish law, the agent will need to prove that it has been duly and expressly empowered[2] to carry out this enforcement.

i Security

The following security interests can be created under Spanish law.

2 The power of attorney will need to be notarised and, where appropriate, apostilled or legalised.

Pledges

Pledges are created over moveable assets and possession over the collateral must be transferred to the pledgee.

Standard pledges include:

a pledges over shares; and

b pledges over credit rights (e.g., those arising from the balances in bank accounts, operational agreements, insurance policies or hedging agreements).

Real estate mortgages

Real estate mortgages are created over any real estate property, and must be executed in a public deed before a notary public and registered with the Land Registry where the asset is located. Real estate mortgages generate significant costs and taxes.[3]

Spanish law provides for the possibility of creating a floating mortgage, which is a security interest created over a specific real estate asset to secure an indefinite number of liabilities up to a maximum cap. Floating mortgages can only be granted in favour of financial institutions and public authorities (and in the latter case, exclusively to guarantee tax or social security receivables). The floating mortgage deed must include a description of the actual or potential secured liabilities, the maximum mortgage liability (which will cover all the obligations without allocating mortgage liability to each of them), the term of the mortgage and the method of calculating the final secured amount and payable balance.

Chattel mortgages and pledges without displacement

Chattel mortgages can only be created over:

a business premises;

b cars, trains and other motor vehicles;

c planes;

d machinery and equipment; and

e intellectual and industrial property.

There is a specific type of mortgage for ships (naval mortgage). The chattel mortgage must be executed in a public deed before a notary public and registered with the Moveable Assets Registry.

Pledges without displacement can only be created over:

a harvests;

b harvest from agricultural plots;

c animals on plots;

d harvesting machinery;

e raw materials in warehouses;

f merchandise in warehouses;

g art collections; and

3 These costs include: (1) stamp duty (described in Section III, *supra*); (2) notarial fees; and (3) land registrar fees. The calculation base for these costs is the total amount secured by the mortgage.

h credit rights held by the beneficiaries of administrative contracts, licences, awards or subsidies, provided that this is permitted by law or the corresponding granting title, and over receivables (including future receivables) not represented by securities and not qualifying as financial instruments.

Pledges without displacement must be executed in a public deed or public policy before a notary public, and registered with the Moveable Assets Registry.

Except for pledges without displacement over credit rights and inventories, these security interests are seldom used in Spain mainly because:

a the pledgor or the mortgagor would not be able to sell the relevant assets without the pledgees' or the mortgagees' consent, respectively;

b most of the assets that can be mortgaged with a chattel mortgage (mainly those that are not moveable) can be covered by a real estate mortgage if expressly agreed to by the parties in the real estate mortgage deed; and

c in most cases, those assets that cannot be covered by a real estate mortgage are not valuable enough to warrant the cost of creating the chattel mortgage.

Financial guarantees

Financial guarantees are those that secure the fulfilment of principal financial obligations. Although the meaning of this expression was subject to disagreement among scholars, the most common construction is that obligations pursuant to almost any financing document can be secured by these financial guarantees. Financial guarantees can consist of cash or securities and other financial instruments and certain types of credit rights held by credit institutions. Therefore, the collateral could be made up of shares issued by public limited liability companies – although this is argued by some scholars as regards shares in non-listed companies – and credit rights arising from the balances in bank accounts.

This type of security interest (1) may benefit from a separate enforcement if the debtor becomes insolvent, and (2) as regards pledges over shares, can be foreclosed by a private sale (not in a public auction, as is the general rule under Spanish law) conducted by the depository of the shares or by the pledgee's direct appropriation of the shares, breaching the general Spanish law principle under which any form of foreclosure of a security agreement that permits the holder of the security interest to directly and immediately acquire the secured asset is not allowed.

ii Personal guarantees

Normally, the borrower's shareholders and each of its subsidiaries provide, to the extent permitted by law (specifically, the financial assistance prohibition and conflict of interest restrictions), first demand guarantees or other types of personal guarantees in respect of the fulfilment of the obligations assumed by the borrower under the financing documents.

A personal guarantee may be created by agreement between the creditor and the guarantor or by operation of law. In order to facilitate the enforcement of a personal guarantee against a Spanish company, a settlement clause establishing the method of calculating the outstanding debt is usually included.

Under Spanish law, a guarantor cannot be obliged to pay the beneficiary of the guarantee until all the debtor's assets have been realised. This benefit for the guarantor does not apply in the following cases:

a if the guarantor has waived the benefit;

b if the guarantee is joint and several;
c if the debtor is declared insolvent; or
d if the debtor cannot be sued in Spain.

Additionally, a guarantor may raise against the creditor all the exceptions and defences corresponding to the debtor and which are inherent to the debt.

First demand guarantees, which are not regulated by law, are abstract and independent from the main obligation, creating a primary liability on the guarantor, and are not subject to the debtor's assets being realised. Lenders usually request that all personal guarantees created under the finance documents be first-demand guarantees.

iii Priorities

Security interests are governed by the principle *prior in tempore potior in iure* (i.e., security created earlier has priority over that created later). With respect to real estate mortgages, chattel mortgages and pledges without displacement, priority is determined by the date and time on which they are registered with the public registry, which is deemed to be the date (and time) on which the relevant document for registration was submitted. With regard to ordinary pledges, which are not registered in any public registry, priority is determined by the date (and time) on which possession is transferred. However, Spanish law allows creditors to agree on the priority of pledges and real estate mortgages. Therefore, creditors can agree that all the credits have the same priority or a creditor can decide to cede its priority in favour of another.

Pursuant to the Spanish Insolvency Act, in the context of bankruptcy proceedings, credit rights secured by security interests will benefit from a special privilege up to the value of the collateral. The creditor is generally considered an ordinary creditor in respect of the excess.[4]

iv Subordination

Notwithstanding this, classifying a bankruptcy credit as subordinated credit would entail extinguishing any security granted in the creditor's favour (and, as a result, any special privilege to which the creditor may be entitled). Under Spanish law, subordination can be triggered *ex lege* or *ex contracto*.

Contractual subordination in Spain is in line with international practice. The contractual provisions in this regard are similar to those of other jurisdictions.

Spanish insolvency law refers to a category of subordinated claims, which entails the subordination, by operation of law, of certain claims to the prior payment by the insolvent debtor of all ordinary claims. These subordinated claims include, among others, the following:
a claims that are not notified by the creditors to the insolvency trustee in a timely manner;
b claims that are contractually subordinated to all remaining claims of the debtor;

4 In the context of bankruptcy proceedings affecting Spanish companies, creditors will be divided into two categories: bankruptcy creditors and creditors against the insolvency estate. The list of creditors against the insolvency estate is a closed one and includes expenses incurred in the proceedings and essential basic expenses for the debtor to continue in business (e.g., salaries, utilities), and such creditors will be paid before any uncharged assets are distributed to the bankruptcy creditors. The claims of bankruptcy creditors may be classified as privileged, ordinary and subordinated. Privileged claims may, in turn, be deemed specially or generally privileged.

c claims for interest; and

d most importantly, all rights against the debtor held by legal or natural persons who qualify as 'specially related' to the debtor. This category includes, among others, shareholders with a stake of 10 per cent in the insolvent entity (5 per cent if it is a listed company) when their credit right arose, formal directors or shadow directors, and companies of the insolvent entity's group.

There is also a rebuttable presumption that any person who acquired a credit against the insolvent debtor from any of those related parties within a two-year period from the commencement of the bankruptcy proceedings is also a related party for insolvency law purposes.

Lastly, in accordance with a recent court ruling, a general reference to the regime applicable to profit participation loans (*préstamos participativos*) (which are deemed equity for capital impairment tests set out in the Spanish Companies Law) would not suffice to ensure its subordination in insolvency scenarios. Therefore, it is highly advisable to clearly state in this type of loan that it would be subordinated to the remaining creditors in any event.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

The standards applicable to the issuance of legal opinions in Spain are not very different from those applicable in other jurisdictions. In pure lending transactions, legal opinions are usually issued by counsel to the lenders or arrangers, except when capacity opinions are requested from counsel to the borrowers. This also applies in plain vanilla bond issuances. On the contrary, in high-yield bond transactions it is usual that legal opinions are issued both by counsel to the arrangers or initial purchasers and counsel to the issuer. Limitations apply to disclosing legal opinions to third parties other than the initial addressees. Disclosure without reliance may be permitted in some cases (e.g., if required by law or a court order, or to auditors or rating agencies on a need-to-know basis). Exceptionally, disclosure with reliance is permitted during the syndication of the loan, but this is normally restricted to a very short time frame and is subject to limitations and restrictions (including a requirement for the disclosing entity to notify the opinion provider of such disclosure).

Below is a description of the main issues and most frequent legal reservations in practice in Spain.

i Corporate benefit

Directors of Spanish companies have a general duty to act loyally and diligently, in compliance with the applicable law, and in the best interests of the company.

It is not always easy to prove that providing security or guarantees in the context of a group financing is in the best interests of a company. Any analysis of this circumstance is ultimately factual.

Accordingly, corporate benefit should be analysed on a case-by-case basis considering, among other things, the structure of the group, the nature and amount of the guarantees provided, the purposes of the financing and the direct and indirect consideration received by the relevant guarantor. With regard to downstream guarantees, corporate benefit may be easier to prove. However, courts have always been more suspicious about upstream or cross-stream guarantees.

ii Clawback

According to the Spanish Insolvency Act, any action taken or agreement reached in the two years preceding the declaration of insolvency of a company can be rescinded by the court if the receiver can prove that the action or agreement was 'detrimental to the insolvency estate'. The term 'detrimental' is not defined and has been construed rather broadly by the courts. The Spanish Insolvency Act also provides for certain circumstances in which a detriment to the insolvency estate is presumed to exist. Among others, unless proven otherwise, the granting of security in respect of preexisting or refinanced debt is presumed to be detrimental to the insolvency estate. Moreover, debt prepayment (with some exceptions in secured loans), gifts and other benefits for no consideration are automatically presumed to be detrimental.

However, the Spanish Insolvency Act provides some safe harbours for the refinancing of existing debt, which is protected from clawback risk subject to compliance with specific formalities and majority thresholds, which differ depending on whether or not the refinancing agreement has been subject to court sanction.

iii Financial assistance

Under Spanish law, companies are generally prohibited from providing financial assistance. Breaching this prohibition could entail both liability for directors and the nullity of the transaction in which the financial assistance was provided.

How acquisition finance transactions have been structured to comply with the restrictions on financial assistance (other than creating separate debt tranches) is to implement a debt push down through a forward merger. As from 2009, however, a specific regulation applies to forward mergers whereby if two or more companies merge and any of them has received financing within three years prior to the acquisition of a controlling stake in, or essential assets of, any of the companies that are part of the merger, some protective measures apply. Among others, directors must issue a report justifying the merger and an independent expert must issue a fairness opinion confirming that the transaction is reasonable and that there has been no financial assistance. This provision has been subject to much debate, especially in relation to the scope and effects of the report issued by the independent expert.

iv Security trustee and parallel debt

Spanish law does not recognise the concept of a 'security trustee' who is the beneficial holder of and enforces the security package on behalf of the lenders from time to time. Thus, legal title over a security interest must be held by the creditor of the secured facility.

Furthermore, any parallel debt governed by Spanish law is unlikely to be considered valid, since under Spanish law contracts and obligations are only valid and enforceable if they are based on a valid and legitimate reason.

In view of the above, lenders will need to provide a notarised and (in the case of foreign lenders) apostilled power of attorney in favour of the security agent to enable it to lead a coordinated enforcement process on behalf of all the lenders.

v Acceleration

In the Spanish market, the decision to accelerate loans and enforce security is usually a last-ditch effort once all other alternatives such as debt restructuring have failed. However, Spanish courts have traditionally been reluctant to uphold loan acceleration and subsequent enforcement of security if the default is not deemed to be material. In this regard, as a requirement for the enforcement of mortgages, at least three principal instalments (or any other such amount that entails default on payment for a period of at least three months) must be outstanding.

VI LOAN TRADING

The assignment of a lender's participation under a facility agreement governed by Spanish law may be carried out by:

a assigning the credit rights, which would result in transferring to the assignee the credit rights held by the assignor against the borrower (but not the contractual obligations assumed by the assignor *vis-à-vis* the borrower); or

b assigning the contractual position under the agreement to any third party, and thus the relevant rights and obligations.

Hence, assigning the contractual position under an agreement would be relatively similar to a novation under English law, as it entails the transfer of both rights and obligations and the subrogation of the assignee to the contractual position of the assignor. However, the previous contractual relation needs not to be terminated.

No specific formalities need to be complied with for an ordinary transfer to be effective between the parties. However, under Spanish law, the transfer date must be certain and unambiguous for it to be fully effective *vis-à-vis* third parties and to guarantee the assignee that any payment made by the debtor to the assignor will not release the former from its obligations *vis-à-vis* the assignee. Therefore, it is very common to formalise the assignment agreement in a public deed before a Spanish notary public.

Spanish notarial documents are essentially (1) public deeds, which must be used, among others, for any transaction that requires registration with a land registry and (2) public policies, which can only be used to formalise contracts of a commercial and financial nature corresponding to the ordinary course of business of at least one of the parties.

While the creation and assignment of mortgages must be documented in a public deed, other types of security interests are usually documented in a public policy. The creation or assignment of a mortgage, when documented in a public deed, triggers stamp duty,[5] which must be paid and the mortgage registered for it to be able benefit from the advantages established under Spanish law (particularly, an expedite enforcement proceeding). In turn, pledges without displacement, which must be registered with the Moveable Assets Registry, may be documented in public policies (and thus no stamp duty accrues).

Moreover, some Spanish security interests cannot be assigned to every type of creditor. Floating mortgages can only be assigned to financial institutions and public authorities (and in the latter case, exclusively to guarantee tax or social security receivables) and financial security interests can only be assigned to:

a credit entities;

b investment services companies;

5 See Section III, *supra*. The Spanish tax authorities have recently issued two binding resolutions stating that the total amount secured should be understood as the outstanding amount of the facility as of the effective date of the assignment and not as its mortgage liability, as was the case beforehand. This may have an impact on transactions in which mortgage-secured facilities have been partially repaid by the debtors and on past transactions (the assignees may consider requesting a refund of any excess stamp duty paid).

c insurance companies;
d collective investment in transferable securities;
e mortgage securitisation funds, asset securitisation funds and their managing entities;
f pension funds; and
g financing institutions.

In practice, this constitutes an additional restriction to the Spanish debt trading market.

Syndicated facility agreements governed by Spanish law usually provide for a specific form of assignment agreement, which is used by lenders when carrying out any assignment of their participation in the loan. They also set out the conditions under which an assignment may be carried out without the debtor's consent. While the lenders' aim is to make the above-mentioned conditions more flexible, the borrower usually wishes to limit the concept of 'permitted assignee' or 'permitted assignment' in order for the financing to remain under the control of its banks, namely the banks with which it has a special relationship and is familiar.

It is not unusual for creditors to close the terms and conditions of the assignment pursuant to LMA Trade forms, but executing trade confirmations is generally supplemented with executing the form set out in the facility agreement or any other assignment agreement governed by Spanish law that is subsequently formalised in a public deed. It is particularly important to evidence the title to claim the assigned indebtedness and enforce the security interests and personal guarantees. This is especially relevant for moveable or immoveable mortgages and pledges without displacement, where the creditor must be a registered creditor.

The financial crisis has created a market from what was previously an ancillary practice to financing transactions. Spanish financial institutions are carrying out several competitive processes to transfer single names when they are not confident about a particular economic sector or about the debtor's ability to recover financially. Likewise, credit rights are sometimes grouped together (according to the type of security attached to them or the nature of the debtors) to allow purchasers to acquire groups of hotels, offices or shopping centres by enforcing the relevant mortgages.

Moreover, the financial crisis has left a significant number of debtors (both individuals and SMEs) who have been unable to repay their debts to the banks, thus impairing the banks' default rates and causing them to significantly increase their reserves. With the aim of remedying this situation, as from 2011 Spanish financial institutions have implemented several competitive processes to sell large portfolios of non-performing loans (NPLs), whether secured or unsecured, which have attracted large investment funds and have also brought out an ancillary industry comprised of servicers specialising in credit claims and foreclosed asset management.

VII OUTLOOK AND CONCLUSIONS

Spanish institutions are facing increasing challenges in 2017 owing to the situation of the financial markets, increasing consumer-friendly regulations and the existence of other sources of financing, which are becoming real competitors to traditional bank lending, not only for large multinational Spanish companies but also for SMEs. Banks will have to monitor very closely the effects that Brexit may have on their businesses and activities, and manage their response to new competition simultaneously with the completion of their own reorganisation processes, focusing on their traditional business and continuing with the divestment of their non-core assets. Competitive processes for the sale of single names, NPLs and real estate portfolios are expected to continue during the second half of 2017.

The way that Spanish banks handle the current challenges and adapt to new regulatory requirements will determine lending and secured finance volumes for 2017. The Spanish banks will need to anticipate and manage potential risks and identify new opportunities that may arise in the near future.

Preventing the failure of solvent companies in situations of financial distress has become a priority for the Spanish government. There is a real intention to pay heed to the lessons learned during the financial crisis and to provide more effective restructuring tools going forward. Spanish insolvency law has been radically overhauled during the past few years, although the possibility of further changes and enhancements cannot be discounted.

Chapter 20

SWEDEN

Eric Halvarsson and Fredrik Gillgren[1]

I OVERVIEW

The corporate lending market in Sweden has been fairly active in recent years, mainly driven by excess liquidity in the market and a generally favourable economic cycle. In recent years, increased diversification of the debt capital markets in Sweden has been evident. The main reasons for that diversification are the evolution of a domestic (or regional) corporate bond market and the introduction of new debt products such as unitranche facilities.

Traditionally, the corporate lending market in Sweden has been dominated by domestic and pan-Nordic banks. That has, in particular, been the case since the financial crisis in 2008 when a number of international banks ended their presence in Sweden in favour of shifting focus back to their main markets. However, the increased competition from the bond market and from credit funds has led to challenges to the dominance of the local banks, and it is likely that the diversification and competition among market participants will continue.

Borrowers have benefited from the excess availability of debt capital through lower margins and better contractual terms. However, some of the more aggressive terms that have been prevalent in the London and New York markets have yet to materialise in Swedish deals. For example, lenders are generally still looking for a full set of maintenance financial covenants by non-investment-grade borrowers and Swedish deals with incurrence-based covenants are fairly rare (the exception being deals syndicated in the international capital markets with Swedish borrowers or sponsors).

The Loan Market Association's recommended forms for facilities agreements are widely used in Sweden, in particular in syndicated or club deals. The recommended forms require fairly limited adaptation to work under Swedish law. In addition, on bilateral deals, abridged versions of the Loan Market Association (LMA) documents are sometimes used.

II LEGAL AND REGULATORY DEVELOPMENTS

Lending as such is not a regulated activity in Sweden outside of a consumer context. However, if the entity extending loans also accepts deposits from the public, that constitutes a regulated financing activity, which requires a permit in Sweden (either directly from the Swedish Financial Supervisory Authority (FSA) or through EU passporting rules). Further, if the lending activity is considered to be fairly regular, the entity may be regarded as conducting a

1 Eric Halvarsson and Fredrik Gillgren are partners at Hamilton Advokatbyrå.

permanent financing business in Sweden; in such cases, the FSA must be notified. While the regulatory situation is not entirely clear, more incidental lending to Swedish borrowers does not usually require notification.

Swedish banks are licensed and supervised by the FSA. Sweden has implemented Basel III through the Capital Requirements Directive (CRD) IV. In addition, Swedish banks are subject to even more strict capital adequacy requirements imposed by the Swedish government. Swedish banks are all ranked very high compared to other European banks when looking at capital adequacy after imposing stress tests, mainly because of the high capitalisation combined with low default rates on loan assets.

The Swedish government recently announced an increase of the resolution fee payable by Swedish banks. The resolution fee is similar to a bank levy, and the increase was heavily criticised and led to an amendment of the government proposal. The new fee levels are proposed to enter into force on 1 January 2018.

III TAX CONSIDERATIONS

Interest income for lenders that are tax domiciled in Sweden is taxed as corporate income tax at a rate of 22 per cent. A lender would be tax-resident in Sweden if it is incorporated in Sweden in accordance with the Swedish Companies Act. Non-resident companies with a permanent establishment in Sweden or that own real estate are taxed on Swedish-source income. That is, however, subject to double taxation treaties that Sweden has entered into extensively.

Sweden does not levy any withholding tax on interest payments. For that reason, tax gross-up clauses in loan agreements are usually quite simple, although the standard LMA concepts of qualifying lenders are sometimes included. Sweden does, however, subject to exceptions and tax treaties, impose withholding tax on dividends.

Interest on debt incurred to credit institutions and other third-party lenders is fully deductible for Swedish companies. However, interest expense on debt owed to affiliated companies is not deductible unless the affiliated receiver of the interest income is taxed at a rate of at least 10 per cent, or if the debt has been incurred primarily for 'business reasons'. The latter test may be difficult to pass as the tax authorities will look at whether the financing could have been provided by other means, for example, through shareholder's contributions or subscription of new shares. Consequently, borrowers with foreign holding company structures may have to carefully consider whether the interest expense under intercompany loans will be tax deductible at all. In the absence of thin capitalisation rules in Sweden, the limits on tax deductibility in respect of intercompany loans have been one of the tools for the government to limit tax avoidance by setting off Swedish income against high interest expense on intercompany loans from, potentially, low tax jurisdictions.

There is currently an ongoing oversight of the Swedish corporate taxation regime. However, the main part of the legislation is yet to be proposed to the Swedish parliament.

For the purpose of the US Foreign Account Tax Compliance Act (FATCA), Sweden has entered into an agreement with the US government and also enacted legislation for the purpose of complying with the intergovernmental agreement. The Swedish agreement is based on Model 1 of the intergovernmental agreement models. As a consequence of the implementation in Sweden, FATCA is normally not an issue in Swedish corporate lending transactions.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

General

If security is to be taken over assets located in Sweden, it is important to have the security created in accordance with Swedish law. While Swedish courts may recognise the validity of a security interest created under a non-Swedish-law governed-security document, assuming it is valid under the law governing the security document, the enforceability in Sweden is nevertheless subject to the requirement that necessary actions to create and perfect the relevant form of security under Swedish law have been taken.

Security can be created over nearly every type of asset in Sweden. However, it is not possible to create security over all or substantially all of the assets of a particular company under a single all-asset-encompassing security document, and, hence, security must be taken on an asset-by-asset basis.

Below is a brief overview of the common methods of taking security over certain assets in Sweden, that is, how security over such assets is typically created, perfection requirements and the extent of any registration, tax or other costs involved.

Real estate

Security over real estate is created by way of a mortgage and registration with the Land Registration Authority. Upon an application by the legal and registered owner of a real estate, the registration authority issues mortgage certificates, which, when pledged and handed over to a creditor, represent a security right with a certain value and a certain priority. Mortgage certificates can be issued in either paper or electronic form. A mortgage certificate in electronic form will be regarded as handed over to the creditor when it has been transferred to the creditor's account in the mortgage register (or to the account of a third party representing the creditor) kept by the Land Registration Authority. The electronic mortgage system is available to local banks only.

Certain assets (e.g., machinery) may be regarded as industrial accessory equipment or fixtures, and would then be covered by a mortgage.

In essence, the security interest created by a mortgage entitles the secured creditor to payment out of the proceeds from a sale of the relevant real estate up to an amount equal to 115 per cent of the amount of the mortgage certificates issued and held by it as security.

The issuance of a new mortgage certificate attracts a stamp duty cost of 2 per cent of the amount secured (i.e., the face value of the mortgage certificate). However, any mortgage certificates already issued can be pledged again without incurring any additional stamp duty.

Tangible moveable property

The only practical way to create security over tangible moveable property is by way of a business mortgage. The reason is that security by way of a pledge over such property requires the transfer of possession of the property, and the pledgor must be excluded, both legally and practically, from dealing with the pledged property. Consequently, it is difficult to obtain perfected security over tangible moveable property other than through a business mortgage.

A Swedish company may file an application with the Companies Registration Office for the issuance of business mortgage certificates, which, when pledged and handed over to a creditor, represent a security right with a certain value and a certain priority. Business mortgage certificates can be issued in either paper or electronic form. A mortgage certificate in electronic form will be regarded as handed over to the creditor when it has been transferred to the creditor's account in the business mortgage register (or to the account of a third party representing the creditor) kept by the Companies Registration Office. The electronic business mortgage system is available to local banks only.

A business mortgage covers all of the pledgor's movable property (other than cash at hand and bank deposits, shares and other tradable financial instruments and securities) used in the pledgor's business. However, security by way of a business mortgage does not prevent the pledgor from disposing of the relevant assets, and it is also subordinate to other perfected pledges over the same assets, even if such pledges are created after the business mortgage. A debtor may, therefore, pledge, for example, receivables that form part of a pre-existing business mortgage, and the pledge of the receivables will then rank ahead of the business mortgage.

A business mortgage gives the secured creditor a specific right of priority enforceable in bankruptcy and execution. A secured creditor who holds a business mortgage certificate is, in conjunction with a levy of execution or bankruptcy, entitled with the right of priority to which the business mortgage is entitled pursuant to law, to receive payment for its claim from the assets covered by the business mortgage up to the face amount of the business mortgage certificate (plus a supplement).

The issuance of a new business mortgage certificate attracts a stamp duty cost of 1 per cent of the amount secured (i.e., the face value of the business mortgage certificate). However, any business mortgage certificates already issued can be pledged again without incurring any additional stamp duty.

Shares and financial instruments

Security over shares and other financial instruments is created by way of a pledge. A share pledge is perfected by transfer of possession of the relevant share certificates (if the relevant shares are in certificated form and share certificates have been issued) to the pledgee (endorsed in blank) or, if no share certificates have been issued, through notification of the pledge to the company's board of directors.

If the shares or other financial instruments are in dematerialised registered form and held on a securities account, perfection is made by registration with Euroclear Sweden or, if held on a deposit account (as opposed to a securities account), through notification of the pledge to the account bank. Other financial instruments that are not in dematerialised form (i.e., in bearer form) require transfer of possession in order to be perfected.

Contractual rights and receivables

Security over contractual rights and receivables is created by way of a pledge. Such pledge is perfected through notification of the pledge to the contractual counterparty or receivable debtor, as applicable. If the receivables are in the form of a bearer promissory note (or similar), the pledge is perfected by transfer of possession of the relevant promissory note to the pledgee (endorsed in blank). Proceeds are to be paid directly to the pledgee and the pledgor may not have control over any account to which payments are made.

Security over receivables may be cumbersome for the pledgor as it must have no disposal rights in respect thereof. A pledge requires that the secured creditor has total control over the payment of the receivables, meaning that all debtors must be notified of the pledge and instructed to pay to an account which is not controlled by the pledgor.

Security over receivables can also be created by way of a business mortgage as referred to above.

Cash deposits

Security over cash deposits on bank accounts is created by way of a pledge. Such pledge is perfected through notification of the pledge to the account bank. The pledgor must not be allowed to withdraw funds standing to the credit of the pledged account without the express consent of the secured creditor.

For practical reasons it may be undesirable to block the bank account, and the parties may, therefore, sometimes agree that the pledge over the bank account will not be perfected until the occurrence of an event of default (or similar triggering event). However, non-perfected security will be subject to a three-month hardening period from the date of perfection and could be clawed back in a following bankruptcy.

Intangibles and intellectual property rights

Security over patents and trademarks is created by way of a pledge registered with the Patent and Registration Office. No similar registration is available for copyrights and, given that there is no counterparty or official registry to which a notification of pledge can be given, this form of security may not be created over copyrights or goodwill.

Security over patents and trademarks can also be created by way of a business mortgage, which would also cover copyrights and goodwill.

ii Guarantees and other forms of credit support

Guarantees are common in Swedish secured (and unsecured) lending transactions. There are no formal requirements, but guarantees are normally made in writing. It is common to include the guarantee in the loan agreement and to make the guarantor a party to the loan agreement. Separate guarantees – either unilateral or documented in an agreement – are also common if, for some reason, the guarantor will not be a party to the loan agreement.

Negative pledge undertakings are commonly included in both loan agreements and security documents.

iii Priorities and subordination

In Sweden, contractual and structural subordination are common ways to ensure a certain priority order. On more complex leveraged finance transactions, an intercreditor agreement will regulate the priority of debts and security, while in lesser structured transactions, a short-form subordination undertaking or agreement may be used. Under the intercreditor or subordination agreement, the parties will contractually agree on a certain order of priority. The ranking of security is normally dealt with in the relevant security documents (i.e., the security provider will grant first and second ranking security to certain creditors, either in the same security document or in separate security documents), and will be underpinned by the intercreditor or subordination agreement.

Structural subordination (i.e., when the creditors lend to different entities in the corporate structure) is common on mezzanine transactions, although there has been a firm pushback from mezzanine lenders on structural subordination.

Intercreditor agreements have not been fully tested by Swedish courts, so there is uncertainty as to whether some of the provisions of standard intercreditor agreements will be upheld (in particular, release provisions in respect of subordinated debt). Further, in case of formal bankruptcy proceedings involving a Swedish company, the bankruptcy administrator can elect whether the estate will be bound by the intercreditor agreement.

In case of the insolvency of a borrower being declared bankrupt, the ranking and priority is dependent on the type of claim. There are three main types of claim, namely claims with special priority (e.g., secured claims, claims secured by mortgage and claims secured by seizure), claims with general priority (e.g., claims given priority because of public interest) and claims without priority.

Within the group of claims with special priority, the claims will be entitled to be paid out of the proceeds from a sale of the assets being subject to the relevant security.

If any assets remain after the claims with special priority have been discharged, claims with general priority will be discharged out of the remaining assets. Within the group of claims without priority, all claims rank equal in priority (*pari passu*) and will be discharged *pro rata*.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal limitations on validity and enforceability

Swedish financial assistance restrictions are fairly strict and apply to loans, security and guarantees.

In general, a company may not grant loans or provide security or guarantees for loans granted to (1) a person who is a shareholder, director or managing director (including its respective relatives) of the company or another company within the same group of companies or (2) legal entities controlled by any such person.

There are a number of exceptions to this general restriction – the most widely used is when the entity whose obligations are being guaranteed is an entity within the same group as the company providing the financial assistance. This exception also applies when the parent entity is a foreign legal entity similar to a company and domiciled within the European Economic Area.

However, even if such financial assistance falls within this exception, if it takes the form of security or guarantees, such security or guarantees must also comply with the Swedish transfer of value rules, which apply to, for example, upstream and cross-stream security and guarantees. Under those rules, a company must generally not undertake a transaction without deriving real and adequate corporate (commercial) benefit from it. Thus, when a company is providing security or a guarantee for a third party's obligation, it must be considered whether the company gains any benefit from the transaction. A guarantee without sufficient corporate benefit may nonetheless be valid if the value of the guaranteed amount does not, at the time when the guarantee is provided, exceed the amount available for distribution by the company as dividends.

In addition, a company may not provide financial assistance, either by way of an advance, a loan or security or guarantees for a loan granted to a debtor for the purpose that the debtor shall acquire shares in the company or shares in its (direct or indirect) parent company or any other company placed above or at the same level as the company in the group structure. Consequently, a Swedish company may not normally guarantee or provide security for debt incurred for the purpose of financing an acquisition by the debtor of the shares in the Swedish company or its Swedish parent company.

The prohibition applies to financial assistance given before or simultaneously with the acquisition of shares, but not after the acquisition. Therefore, a loan, security or guarantee or any other financial assistance provided after the acquisition, where the funds are used to pay for the acquired shares or repay financing incurred in connection with such acquisition, will not be prohibited. The time period that must lapse between the acquisition and such financial assistance to avoid the prohibition is unclear and must be established on a case-by-case basis. However, to be on the safe side, the period should be at least three months. There is no whitewash procedure available under Swedish law.

ii Legal opinions practice

Legal opinions as to matters of Swedish law are regularly delivered on international, cross-border and syndicated loan transactions, but rarely on purely domestic bilateral or club deals with all-Swedish lenders. In Sweden, creditor counsel would typically deliver the opinion, both as to capacity and authority of any Swedish obligors and enforceability of any Swedish law governed transaction documents, but sometimes both debtor and creditor counsel deliver the opinions (debtor counsel as to capacity and authority and creditor counsel as to enforceability). The opinions are typically addressed to, and capable of being relied upon by, the original lenders or finance parties named in the loan agreement and sometimes also parties that become lenders in connection with primary syndication or within a certain time period from signing or first utilisation. Copies of opinions may typically be disclosed for information purposes only to (but not be relied upon by) parties that may potentially become lenders, their and the addressees' auditors, legal and other professional advisers and persons to whom an addressee is required to disclose the opinions under applicable law, without consent of the opining counsel.

iii Choice of foreign law and recognition and enforcement of foreign judgments

The choice of foreign law as the governing law of a loan agreement or security document will typically be recognised and upheld as a valid choice of law by the courts of Sweden (subject to the provisions of the Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I)).

A final and conclusive judgment rendered by a court in a contracting state to: (1) the Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I 2000 Regulation), in respect of legal proceedings instituted before 10 January 2015; (2) the Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I 2012 Regulation), in respect of legal proceedings instituted on or after 10 January 2015; (3) the Convention on jurisdiction and the enforcement of judgments in civil and commercial matters made in Brussels on 27 September 1968 (as amended) (Brussels Convention); or (4) the Convention on jurisdiction and the enforcement of judgments in civil and commercial matters made in Lugano on 16 September 1988 (Lugano Convention), and which is enforceable in such state, will be recognised and enforceable by the courts of Sweden according and subject to the Brussels I 2000 Regulation, Brussels I 2012 Regulation, Brussels Convention or Lugano Convention, as applicable.

In order to enforce a judgment under the Brussels I 2000 Regulation, Brussels Convention or Lugano Convention in Sweden, the concerned party must submit an application for enforcement to Svea Court of Appeal and comply with the procedures of that court (as required).

According to Swedish case law, a judgment given by a court in a state not being a contracting state to the Brussels I 2000 Regulation, Brussels I 2012 Regulation, Brussels Convention or Lugano Convention would only under certain circumstances be recognised and be regarded by a Swedish court as evidence of the outcome of the dispute to which such judgment relates, and a Swedish court would still, even if such circumstances were found to be applicable, have the possibility to rehear the dispute *ab initio* or may consider such judgment to be a matter of legal fact upon which a Swedish court may render its own judgment inquiring only as to whether all procedural aspects in the applicable courts of the non-contracting state have been observed.

VI LOAN TRADING

Most Swedish corporate loan agreements include transfer provisions, and loan participations are traded in Sweden similarly to other jurisdictions. As novation is not a recognised legal concept in Sweden and may have the result of restarting a hardening period for security, assignments and transfers are the recommended methods for transferring loan participations. Under Swedish law, an assignment of rights under a contract requires notice to the contract party (i.e., the borrower in a loan agreement context), so loan agreement clauses should ensure that the borrower is notified of any transfers.

Under a standard Swedish loan transfer clause, a proportional interest of any security interest is also transferred. That is sufficient to ensure that the related security will benefit the assignee from the transfer date.

Sub-participation and other forms of transfers without changing the lender of record are possible in Sweden and are common in the market. However, a sub-participation will normally not be legally enforceable against the borrower (as it is not notified of any transfer of rights), and the transaction is, therefore, dependent on the contractual terms between the lender of record and the sub-participant. The borrower will continue to make payments to the lender of record and will discharge its obligations by paying to the lender of record.

VII OUTLOOK AND CONCLUSIONS

As discussed in Section I, *supra*, the diversification of the Swedish market is likely to continue. While the Swedish banks are well capitalised and profitable, the banks will be under pressure from increased costs for capital requirements and other regulatory initiatives. That will probably continue to drive the market entry by other participants, such as Swedish and foreign credit funds and other alternative debt providers, such as insurance companies and similar. Swedish and pan-Nordic banks have generally been able to offer very competitive pricing on corporate loans and, thus, been able to hold onto a significant market share compared to, for example, international financial institutions. While it is likely that the banks will continue to be the main source for funding for Swedish borrowers, there is certainly scope for foreign and domestic debt providers to originate and execute loan transactions in Sweden.

Chapter 21

SWITZERLAND

Patrick Hünerwadel, David Ledermann and Marcel Tranchet[1]

I OVERVIEW

With a competitive tax system, stable political environment and skilled workforce, Switzerland is home to a large number of corporations (including major corporations) and to important subsidiaries of many large international groups across a broad range of industries. Consequently, there is very frequently a Swiss component to lending and secured finance transactions of international groups.

The corporate lending market in Switzerland is a well-developed and stable market with experienced participants (banks, borrowers and advisers). Where Swiss borrowers are involved, the market is largely in the hands of banks (Swiss and non-Swiss). On occasion, certain other professional investors (e.g., pension funds and insurance companies) are also involved in the corporate lending market in Switzerland, but this is not often the case. On leveraged finance transactions (especially transactions arranged in the United States but with a Swiss component), it is not uncommon to see specialised lending entities (e.g., collateralised loan obligations funds) participate in such transactions.

Over the past few years, including during the financial crisis, the Swiss corporate lending market has managed to remain stable. It has not had much of a downturn and has seen a low number of distressed borrower situations. Recently, a large number of refinancing transactions and a significant uptrend in acquisition financing transactions could be observed in Switzerland. Also, it appears that non-Swiss banks are more active again in the Swiss market than during the peak of the financial crisis.

II LEGAL AND REGULATORY DEVELOPMENTS

Regulatory developments have not recently had a major impact on the corporate lending market in Switzerland and on documentation. However, the increased capital and liquidity requirements applicable to Swiss banks do have an impact in particular. The regulatory efforts aimed at reducing the balance sheets of major banks (e.g., the leverage ratio) have the effect of putting a limit on the overall volume of available credit. Also, increased attention is paid, on occasion, to collateral aspects of lending transactions to ensure that the particular transaction can be treated as a secured transaction for regulatory purposes. Other regulatory areas that have gained more attention in the context of corporate lending transactions generally are the areas of sanctions and anti-corruption regimes.

1 Patrick Hünerwadel, David Ledermann and Marcel Tranchet are partners at Lenz & Staehelin.

III TAX CONSIDERATIONS

Under Swiss domestic tax laws, interest payments by a Swiss borrower under a bilateral or syndicated financing are, as a rule, not subject to Swiss withholding tax if the Swiss tax law rules commonly referred to as the 'Swiss non-bank rules' are complied with.

These rules address, among other things, a potential tax recharacterisation of a borrowing that is not subject to Swiss withholding tax into a public bond issue that is subject to Swiss withholding tax. This Swiss withholding tax law issue is triggered where:

a a syndicate consists of more than 10 lenders that are not licensed as banks (the '10 non-bank rule');

b a Swiss obligor has, on an aggregate level (i.e., not on a transaction-specific level), more than 20 creditors that are not licensed as banks (the '20 non-bank rule'); or

c a Swiss obligor has, on an aggregate level (i.e., not on a transaction-specific level), more than 100 creditors that are licensed as banks, under financings that qualify as deposits within the meaning of the relevant rules (the '100 non-bank rule').

A breach of the Swiss non-bank rules can result in the applicability of Swiss withholding taxes (currently at a rate of 35 per cent). Such taxes would have to be withheld by the Swiss obligor.

Also, a standard gross-up clause may, in light of a related prohibition in the Swiss Withholding Tax Act, not be valid and enforceable in Switzerland, in particular where the reason for the withholding tax is a breach of any of the Swiss non-bank rules.

A particular tax at source applies to payments secured by Swiss real estate when made to non-Swiss lenders, unless exempted under the applicable double taxation treaty.

No stamp and documentary taxes are payable in Switzerland in respect of the execution or delivery of loan and security documentations as a condition to the legality, validity, enforceability or the admissibility in evidence thereof in Switzerland. Notary fees and registration duties may be payable with respect to documents that are drawn up as public deeds, or need to be filed with a registry (e.g., security on real estate, title retention).

Where participations in a loan are evidenced by debt recognitions or instruments that are taxable under the Swiss Stamp Tax Act, a transfer thereof made by securities dealers (as defined in the Swiss Stamp Tax Act) as a principal or intermediary are subject to Swiss federal turnover taxes.

Finally, it has become common practice in the Swiss market to insert Foreign Account Tax Compliance Act provisions in cross-border financing transactions. These provisions are largely based on the corresponding recommendations published by the Loan Market Association but typically provide for certain changes that have become market practice in Switzerland.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Taking a valid and enforceable security interest over assets and rights located in Switzerland or governed by Swiss law typically requires that appropriate security agreements governed by Swiss law be entered into.

As a matter of Swiss conflict of laws rules, the security provider and the secured party are generally free to choose the governing law of the security documents (with certain exceptions). However, Swiss conflict of laws rules typically provide that such a choice of law is not enforceable against third parties, including the creditors of the security provider. Given the importance of enforceability of collateral, it is, therefore, market practice for assets and rights located in Switzerland or governed by Swiss law to create the required security interests pursuant to security documents governed by Swiss law and providing for jurisdiction in Switzerland.

Swiss law does not allow the taking of a floating charge or 'blanket' security (or similar security concepts), namely the granting of a security interest over all or substantially all assets and rights of the security provider, irrespective of their type or nature. Swiss law provides that, for a security interest to be validly granted, the assets and rights to be covered by such a security interest have to be clearly identified or identifiable and the substantive requirements for each type of assets or rights have to be complied with. This is one of the reasons for which it is market practice in Switzerland that separate security documents are prepared for each security asset class and one does not see, in the Swiss market, single security documents in relation to all or various asset classes.

The exact scope of a Swiss security package is determined on a case-by-case basis and is driven by a number of factors, including what are the meaningful assets of the particular security provider. The following assets classes are typically considered: shares, bank accounts, receivables and other contractual rights, real estate, intellectual property rights and, on occasion, tangible moveable property.

Shares

The creation of a security interest over shares of a Swiss company (either a corporation limited by shares or a limited liability company) takes the form of a pledge. The creation of a valid pledge over shares of a Swiss company requires the parties to enter into a written pledge agreement. There is no requirement for such an agreement to be notarised and it can be entered into in counterparts.

The requirements for creating a share pledge governed by Swiss law depend on whether the shares have been certificated or whether they have been dematerialised. Also, certain special rules apply where shares constitute book-entry securities within the meaning of the Swiss Book-Entry Securities Act.

If the relevant shares are certificated, the creation of the pledge requires that the physical share certificates be delivered to the pledgee or its agent. If the shares are registered shares the share certificate must be endorsed or assigned (and it is customary to require that the share certificate delivered to the pledgee be endorsed in blank by the pledgor).

If the relevant shares are dematerialised (i.e., not certificated), the perfection of the pledge requires that the pledgee and the bank holding the pledged shares in custody enter into a written control agreement, whereby the bank will act for all practical purposes as pledge holder for the benefit of the pledgee.

Registered shares of Swiss corporations are often subject to share transfer restrictions (i.e., provisions that condition the transfer of title to the shares to the approval of the board of directors of the issuer of the pledged shares). As the board of directors of the issuer may not be cooperative in an enforcement scenario, it is customary for secured lenders to require that any such transfer restrictions be removed prior to the pledge being granted. Eliminating share transfer restrictions requires an amendment to the articles of association, which requires, among other things, a shareholders' meeting held before a notary public. This process takes some time and it is, therefore, best to address this issue early in the process.

Share pledge agreements very typically also contain provisions dealing with the exercise of voting rights and rights to any dividend payments. Typically, the pledgor retains the right to vote the pledged shares as long as no event of default (or similar event) has occurred. Voting rights can then be exercised by the pledgee or its agent upon the occurrence and during the continuance of such an event. With respect to dividend rights, such rights are also typically pledged, but it is customary to provide that the pledgor is entitled to collect dividends as long as no event of default has occurred. It is often also provided that dividend payments are to be made to a pledged account.

Bank accounts

The creation of a security interest over a bank account is somewhat a misnomer in that the actual asset on which a security interest is created is the claim of the bank account holder against the bank for any amount standing to the credit of the bank account. Creating a security interest over a bank account can take the form of a pledge or of an assignment for security purposes. Both types of security require a written agreement (no notarisation is required), and no other step is legally required for perfecting such a security interest. However, until the account bank is notified of the security interest, it may freely pay any amount due to the account holder or to a designated payee. It is, therefore, customary to notify the account bank of the creation of the security interest with the ensuing result that the account bank may then only discharge its payment obligations towards the account holder with the consent of the secured creditor.

Bank accounts held with Swiss account banks are governed by the general terms and conditions of the relevant bank. The general terms and conditions typically provide for a general pledge and right of set-off in favour of the bank. Unless the general pledge and right of set-off are waived by the account bank, they rank senior to the security interest of the secured lenders. It is, therefore, customary for secured lenders to request that the general pledge and right of set-off be waived. As banks are often reluctant to waive such rights, it is best to address this issue early in the process and the compromise is often to seek and obtain a waiver, which is subject to reasonable fees of the account bank having priority.

Receivables and other contractual rights

Creating a security interest over receivables or other contractual rights can take the form of a pledge or of an assignment for security purposes. Both types of security require a written agreement (no notarisation is required) and no other step is legally required for creating such a security interest. As for bank account security, the notification of the security interest to the debtor of the receivables is not a requirement for the validity of the security interest, but is advisable to protect the secured lenders. There are two other reasons for which an early notification is in the interest of the secured lenders: without notification, the assigned debtor can (1) validly raise against the assignee any defence or objection (including set-off) it could have raised against the assigned debtor at the time of the assignment notification; and (2) validly set-off against the assignee a claim that was not due at the time of the assignment notification, provided the claim did not become due after the assigned claim.

It is, therefore, market practice that the security interest be notified to the assigned debtor, but the timing of the notification depends on the type of receivables or rights.

For trade receivables for which there is often some sensitivity on the part of the security provider to see its clients and customers being notified of a security interest, it is often the case that notification is made upon the occurrence of an event of default only or upon it otherwise becoming necessary in the discretion of the secured party to protect the security interest. Also, the security provider is often required to grant a security interest over the bank accounts to which payments are made by the assigned debtors.

With respect to intercompany receivables or other rights where there is less sensitivity to immediately disclose the existence of a security interest (such as a security interest over insurance claims), it is customary to provide that the existence of the security interest is notified to the relevant assigned debtor concurrently with the entering into of the security document.

Under Swiss law, it is possible to create a security interest not only on existing receivables but also on future receivables provided they can be identified upon coming into existence. The Swiss Supreme Court has ruled that this requirement is satisfied when such future receivables are identified as arising in the ordinary course of the business of the assignor. However, from a practical standpoint, such a designation would be of little use to the secured creditors without a periodic reporting of the grantor of the outstanding receivables, identifying the amount, nature and debtors of the receivables covered by the security interest. Without such information, it may be not be possible for the secured creditors (or their security agent) to notify the security interest to the relevant receivable or right debtors and to enforce or collect the receivables or rights.

Tangible moveable property

Creating a security interest over tangible moveable property would take the form of a pledge and requires a written pledge agreement (no notarisation is required).

As perfection of the pledge over tangible moveable property requires the security provider to transfer possession over the pledged assets to the secured lenders (or their security agent), taking a security interest over operational moveable assets (such as inventory, work in progress or industrial tooling) is usually not compatible with operational requirements of the security provider and is therefore an infrequent form of security in Switzerland.

Where the security provider stores tangible moveable property with third parties (e.g., an oil refiner storing crude or refined products in storage capacities owned by a storage operator), it may be possible to create a valid security interest over the tangible moveable property with the third parties acting as pledge holders.

Real estate

In the context of secured lending, taking a security interest over real estate located in Switzerland usually takes the form of a transfer for security purposes of a mortgage note charging the relevant real estate property. Secured lenders should pay attention to restrictions that may affect residential real estate deriving from the Swiss Federal Law on Acquisition of Real Property by Foreigners. Also, as mentioned in Section III, *supra*, a tax at source may apply to interest payments secured by Swiss real estate when made to non-Swiss lenders (exceptions under applicable double taxation treaties).

Intellectual property rights

Creating a security interest over intellectual property rights would take the form of a pledge and requires a written pledge agreement (no notarisation is required). From a Swiss law perspective, no other step is generally required for perfecting such a security interest, bearing in mind that with respect to registered intellectual property rights (trademark, patents, design rights) such a pledge would only become enforceable towards good faith third parties upon the pledge being registered with the relevant intellectual property register. In practice, such a registration is often a post-closing item.

Security agent

It is possible under Swiss law that security is granted to, and held by, an agent and security documents can be drafted such that it is not necessary to amend them upon a change of the secured parties. Where the security interest is a security assignment or a security transfer, the security agent can act in its own name for the benefit of the secured parties. Where the security interest is a right of pledge, it is necessary that the security agent act as direct representative of the secured parties (i.e., in the name and on behalf of the secured parties). The reason for this is that a Swiss law pledge is accessory in nature, meaning, among other things, that the secured party must be identical to the creditor. This can be achieved by having the security agent act as a direct representative, which is the standard approach in Switzerland when accessory security interests are involved (with exceptions for very specific transactions, where it might be necessary to adopt another approach). An alternative approach would be to create a parallel debt and to secure this parallel debt, as this is done in a number of other jurisdictions. However, the concept of parallel debt remains untested in Switzerland and doctrine is scarce. It is for this reason that the parallel debt concept is not frequently used in Swiss security documents (at least not on a stand-alone basis).

ii Guarantees and other forms of credit support

Swiss law distinguishes two types of guarantee instruments: the guarantee (Article 111 of the Swiss Code of Obligations) and the suretyship (Article 492 et seq. of the Swiss Code of Obligations).

Guarantee

Article 111 of the Swiss Code of Obligations provides that whoever promises to another the performance by a third person of a certain act is obligated to compensate him or her for the financial prejudice arising therefrom if the performance does not occur. Under Swiss law, a guarantee is an undertaking independent of the validity of the guaranteed obligation between the debtor and the creditor, in other words it constitutes a primary and independent obligation that typically is not subject to any defence or objection that relates to the guaranteed obligation. No specific form is required under Swiss law for a guarantee, although the written form is usual. The indication of the maximum amount guaranteed is not required.

Suretyship

A suretyship is an obligation of an accessory nature. Its validity depends on the validity of the underlying obligation. Therefore, a guaranteed party is only in a position to exercise its rights under a suretyship to the extent the underlying obligation is valid, due and enforceable. As a result, a surety is subject to the defences and objections of the debtor of the underlying obligation. A 'simple suretyship' requires that the principal debtor be adjudicated bankrupt or subject to composition proceedings before it can be acted upon. A 'joint suretyship' allows the guaranteed party to act upon default of the debtor under its primary obligation. Formal requirements are required in connection with suretyship agreements, such as that it be made in writing and provide for a maximum amount.

In practice, the form of the guarantee is the dominant form in a corporate lending context. Also, in the context of international secured financing transactions where the facility agreement would often be governed by English law or New York law, a guarantee provided by a Swiss guarantor would typically also be governed by English law or New York law as there is no requirement under Swiss law that the guarantee issued by a Swiss guarantor be governed by Swiss law.

iii Priorities and subordination

Under Swiss law, the priority of a security interest depends on the type of assets considered:

a with respect to real estate, the priority results from the entry of the mortgage or mortgage note into the land registry;

b with respect to certificated shares, the perfection of a security interest is subject to a transfer of possession, so that third parties should not be able to take subsequent security over these assets without the consent of the pledgee; and

c with respect to trade receivables or other receivables, the order of priority is set by chronological order with the first security interest granted being senior to any security interest granted subsequently.

Subordination is typically effected by contractual agreement in the intercreditor agreement.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

In the context of group-wide financing transactions or acquisition financing transactions, it is common practice for lenders to request that all significant group companies provide guarantees or other security interests.

It is the prevailing view in Switzerland that the provision of upstream guarantees (i.e., guarantees for obligations of direct or indirect shareholders of the guarantor) and cross-stream guarantees (i.e., guarantees for obligations of sister companies of the guarantor) is subject to a number of requirements and restrictions.

Essentially, it is held that such guarantees should be treated as the equivalent of a dividend distribution as far as formal and substantive requirements and limitations are concerned. The key implication of this is that upstream and cross-stream guarantees are, in practice, limited to the amount that the guarantor could distribute to its shareholders as a dividend at such time as payment is demanded under the guarantee. This limitation is sometimes referred to as the 'free equity limitation'. Also, payments under upstream or cross-stream guarantees may be subject to tax implications, including Swiss withholding tax implications.

Downstream guarantees (i.e., guarantees for obligations of subsidiaries of the guarantor) are not typically subject to restrictions. Exceptions are possible under certain circumstances, for instance, if the subsidiary is not a wholly owned subsidiary of the guarantor or if the subsidiary is in significant financial distress.

The requirements and limitations applicable to upstream and cross-stream guarantees, as referred to above, are also applicable to upstream and cross-stream security interests.

Where, in the context of an acquisition, a Swiss entity (e.g., the target) provides guarantees and security interests for obligations of the acquirer (which will become the parent company of the Swiss target as a result of the acquisition), the Swiss security package would be upstream in nature and thus subject to the various requirements and limitations, including the free equity limitation referred to above. Other issues may arise in such transactions, especially where there are minority shareholders at the level of the target.

A number of steps are taken in practice to bolster the validity of an upstream security package and to mitigate, as far as possible, the imperfections of such security packages. The starting point is to make sure that the articles of association of the Swiss entity explicitly permit upstream undertakings. It is also important to ensure that the finance documents and the transactions contemplated thereby are properly approved by the relevant corporate bodies. In addition, finance documents will typically address the free equity limitation and certain Swiss withholding tax law points, and they will also typically provide for certain undertakings and assurances by the security provider to mitigate, as far as possible, the upstream limitations. Furthermore, parties are typically advised, for corporate law and tax law reasons, to compensate the Swiss entity for the granting of the upstream security package by means of a guarantee fee or security fee.

Under Swiss conflict of laws rules, parties have extensive freedom to agree on the law that should govern their loan documentation, along with the pertaining security documentation. With respect to the latter, certain limitations apply as set out under Section IV, *supra*. Further, parties have flexibility to agree on a foreign jurisdiction with respect to their loan and security documentation. Final decisions for monetary claims of competent foreign courts are recognised in Switzerland either on the basis of particular treaty law (such as the Lugano Convention) or Swiss international private law, provided that the proceedings leading up to the decision comply with basic principles of fair process (as described under the treaty or Swiss international private law) and the decision as to its substance does not violate Swiss public policy.

As a rule, finance parties request legal opinions in international financing transactions, but it is also standard practice for domestic syndicated financing transactions and for domestic bilateral financing transactions of a certain significance. Such opinions may be limited to the capacity of a Swiss party to enter into a financing transaction (maybe also choice of law and jurisdiction), but more often the request for such opinions will be to cover all aspects of the legality and validity of Swiss law documents or the creation and perfection of a Swiss law security interest created thereunder, as well as the enforceability of the loan and security documentation against a Swiss party and the due authorisation and execution of the loan and security documentation by the Swiss party. Tax opinions, typically on the absence of the need for a Swiss obligor to make any withholding or deduction from its payments, are requested as well. There are no firm rules as to which counsel renders what opinion. It is, however, more common in practice for the lenders' Swiss counsel to render the enforceability opinion. At times, capacity, due authorisation and execution are carved out from the enforceability opinion and covered in a separate capacity opinion rendered by obligors' Swiss counsel. The addressees of such opinions are the finance parties at signing and with limitations (e.g., primary syndication) persons that become finance parties after signing. Opinions may typically be disclosed, but not be relied upon, where legally required, or to regulators or advisers of a finance party and also to affiliates of a finance party.

VI LOAN TRADING

In Switzerland, the most common methods of loan trading are assignments of the rights of an existing lender under a particular financing to a new lender (or to another existing lender) and transfers of all rights and obligations of an existing lender under a particular financing to a new lender (or to another existing lender).

Sub-participations and other form of credit risk exposure transactions are also seen from time to time in Switzerland but not very frequently (and rarely only where the underlying financing transaction is a domestic transaction, i.e., a transaction without participation of non-Swiss banks).

No institutionalised markets exist in Switzerland for loan trading. The loan trading market in Switzerland is a bilateral market. Also, borrowers very typically have a consent right to any trading transactions in their loans (save for an event of default scenario), meaning that borrowers very typically need to get involved when loans are traded.

Also, in light of the 'Swiss non-bank rules' (see the relevant summary under Section III, *supra*), facility agreements will typically provide for certain restrictions applicable to loan trading transactions (e.g., a limitation on the maximum number of non-bank lenders in the syndicate and restrictions on the types of permissible credit risk exposure transactions). Also, in structured transactions, tax rulings are obtained on occasion.

VII OUTLOOK AND CONCLUSIONS

No legal or regulatory developments are currently pending in Switzerland that are expected to have a major impact on the Swiss lending market and its documentation. The low interest rate environment will likely continue to be a factor that has an impact on the corporate lending market. Also, the debt capital market has been fairly open recently, including to issuers that may not have been able to tap the debt capital market in the past.

Chapter 22

TAIWAN

Abe Sung and Mark Yu[1]

I OVERVIEW

Banks play a fundamental role as intermediary in the financial market by taking deposits and providing lending to utilise the funds from the general public to finance valuable production and other investment activities. According to the statistics of the Financial Supervisory Commission (FSC), the banking industry regulator in Taiwan, as of March 2017, the total amount of loans provided by financial institutions was approximately NT$28.86 trillion (approximately US$962 billion), a decrease of 0.39 per cent from 2015. As to the Taiwan syndicated loan market, the total amount of Taiwan syndicated loans in 2016 was around US$34.22 billion, consisting of 204 syndicated loans, a decrease of 26.5 per cent from 2015. In 2016, government-owned or managed local banks still dominated the local syndicated loan market. The Bank of Taiwan, Taiwan Cooperative Bank, MEGA International Commercial Bank, Taishin International Bank and Land Bank of Taiwan are the top five banks providing syndicated loans in Taiwan. Except for Taishin International Bank, the other four are government-owned or managed local banks.

II LEGAL AND REGULATORY DEVELOPMENTS

Although banks still have a dominant role in the loan market, developments in technology have seen the peer-to-peer (P2P) lending platform – which provides an online platform for bridging direct lending from non-professional lenders to borrowers of individuals or small businesses – develop as an innovative financial broker. P2P lending, also known as marketplace lending, has become a well-developed or known lending practice in other jurisdictions but is still new to the Taiwan market.

In the face of this new development, the FSC still has concerns. In April 2016, the FSC issued a press release pointing out that the P2P lending platform may (1) become involved in the deposit-taking business, which is regulated by the Banking Act; (2) engage in usury, which would violate the Criminal Law; (3) violate the Fair Trade Act if the platform makes false or misleading statements to potential lenders and borrowers, such as 'high profit, low cost and low risk', which may be deemed as misleading advertising; and (4) breach the Multi-Level Marketing Supervision Act if the P2P lending platform establishes a multilevel mechanism

1 Abe Sung is a partner and Mark Yu is an associate partner of banking and capital market department at Lee and Li, Attorneys-at-Law.

to offer borrowers rewards for recruiting new participants. In addition, personal information leakage may be another key issue in P2P lending. At that time, the FSC was contemplating enacting a law to govern P2P lending in the near future.

Nonetheless, the FSC subsequently issued another press release in September 2016, showing its positive attitude toward fintech including P2P lending. The FSC encouraged banks to take advantage of the power of fintech, including P2P lending, and concurrently enhance internal control mechanisms and reduce risks in P2P lending. Pursuant to a ruling issued by the FSC on 13 December 2016, a bank or a financial holding company may invest in P2P lending platforms as part of its operations.

III TAX CONSIDERATIONS

i Gross business receipt tax

Gross business receipts tax rates for entities in the financial industry (banks, insurance companies, investment trusts, securities firms, futures and commercial paper enterprises, etc.) are as follows:

a 2 per cent on the revenues generated from the regulated businesses (such as a bank's deposit-taking business and a securities firm's underwriting income), except for banks and insurance companies, whose revenues generated from their core businesses from 1 July 2014 onward will apply the rate of 5 per cent;

b 5 per cent on the revenues generated from non-regulated businesses (such as a bank's rental income from office leases); and

c 1 per cent on an insurance company's reinsurance premium income.

ii Withholding tax

For a foreign lender that is a non-Taiwan resident or a profit-seeking enterprise without a fixed place of business in Taiwan, the withholding tax rate for interest applicable to a corporate borrower is 20 per cent, but for interest earned on short-term commercial papers, securitised instruments, government, corporate or financial institution bonds, or conditional transactions, the withholding tax rate is 15 per cent. Moreover, most tax treaties provide a reduced income tax withholding rate of 10 per cent. Taiwan has signed tax treaties with 32 jurisdictions, namely, Australia, Austria, Belgium, Canada, Denmark, France, Gambia, Germany, Hungary, Indonesia, India, Israel, Italy, Japan, Kiribati, Luxembourg, Macedonia, Malaysia, New Zealand, the Netherlands, Paraguay, Poland, Senegal, Singapore, Slovakia, South Africa, Swaziland, Sweden, Switzerland, Thailand, the United Kingdom and Vietnam.

iii Income tax

Under the Income Tax Act, any interest income that is deemed Taiwan-sourced income is subject to Taiwan income tax in general. In general, the interest paid by a local borrower to a foreign lender will be deemed Taiwan-sourced income. The following types of income are exempted from income tax:

a interest on loans offered to Taiwanese government or legal entities within the territory of Taiwan by foreign governments or international financial institutions for economic development, and interest on the financing facilities offered to their branch offices and domestic financial institutions within the territory of Taiwan by foreign financial institutions;

b interest on loans extended to legal entities within the territory of Taiwan by foreign financial institutions for financing fundamental infrastructure projects under the approval of the Ministry of Finance; and
c interest on export loans at favourable interest rates offered to or guaranteed for legal entities within the territory of Taiwan by foreign governmental institutions or foreign financial institutions that specialise in offering export loans or guarantees.

Moreover, some of the tax treaties provide an exemption from income tax withholding for interest payments. For example, the Netherlands–Taiwan Tax Treaty provides that the interest paid in respect of a bond, debenture or other similar obligation of a Taiwanese public entity, or of a subdivision or local authority of Taiwan, should be taxed only in the Netherlands.

iv Documentary tax

No notarisation or stamp duty is required for the creation of a security interest over different types of assets such as (1) a mortgage over real properties; (2) a chattel mortgage over a moveable asset, such as machinery and equipment; (3) a pledge over moveable assets or securities, or a pledge over the pledgor's rights that are transferable, such as the pledgor's rights to bank accounts, accounts receivable or patents; and (4) a secured assignment of property rights.

v Foreign Account Tax Compliance Act (FATCA)

To prevent US taxpayers who hold financial assets in non-US financial institutions and other offshore accounts from avoiding their tax payment obligations, FATCA generally requires foreign financial institutions to enter into agreements with the Internal Revenue Service (IRS) to identify US accounts and report certain information about those accounts and investments held by US taxpayers to the IRS on an annual basis. If they fail to enter into such agreements to report US accounts, they will face a 30 per cent withholding charge. In 2014, the FSC announced that Taiwan is recognised by the United States as a jurisdiction having Agreement in Substance status in respect of FATCA. This status allows Taiwanese financial institutions to be exempted from the 30 per cent withholding tax on incomes from the United States.

Taiwan and the US signed the Intergovernmental Agreement of FATCA (IGA) on 22 December 2016, and the IGA is pending the review and approval of Taiwan Legislative Yuan. After the IGA takes effect, the IRS may request the Taiwan competent authority to provide detailed information of the recalcitrant accounts.

As to the lending market in Taiwan, lenders recognise that in practice they need to be FATCA-compliant to participate in the lending market. To prevent the residual risk of FATCA withholding being imposed on lenders, the standard FATCA provisions, such as excluding FATCA from the tax gross-up and tax indemnity provisions, are normally provided in the loan agreement. The lending market has typically accepted such provisions, which have become a standard part of the loan agreement.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Under Taiwan law, different types of assets are subject to different formal requirements for perfection of a security interest created over them. Below is a brief introduction to the formal requirements on the most commonly seen security interests. Taiwan law does not permit the taking of security over 'all assets' of an entity by way of floating charge. As a general rule, the security provider and the security interest holder should enter into an agreement to identify the specific asset subject to the security interest. A general security agreement that does not identify the specific asset, such as a floating charge, is not enforceable under Taiwan law.

Chattels

The security to be created over machinery and equipment may be a pledge or a chattel mortgage. Both security interests give the security interest holder first priority over the machinery and equipment. To create a pledge, the pledgor and the pledgee have to enter into a written agreement and the pledgor should deliver the possession of the machinery and equipment to the pledgee, but a registration with the competent authority is not required. To create a chattel mortgage, the mortgagor need not deliver the possession thereof to the mortgagee; however, a registration with the competent authority will be necessary for the mortgagee to claim the chattel mortgage against a *bona fide* third party.

Real properties

A security interest over real properties is taken by way of a mortgage registered with the relevant land registration offices. A security interest over real properties will not be validly created if registration is not duly completed. To create a valid mortgage over land, a building or a plant, the mortgagor and the mortgagee should enter into a written agreement and complete the registration.

Bank accounts

The deposit in a bank account can be pledged by way of a written agreement executed by the depositor and the lender and a notice of the creation of the pledge served on the account bank. The pledge will only be perfected when a notice has been served on the account bank. Nevertheless, as described above, the concept of a floating charge is not recognised under Taiwan law. In other words, the pledge covers only the cash in the bank account when the pledge is created and notified to the account bank. The pledge will not cover the cash deposited in the bank account after the account bank is notified of the creation of the pledge. To deal with this issue, the pledgor in practice will be required to periodically confirm with the account bank and agree on the creation of a pledge over the most current balance in the bank account to ensure that the pledge also covers the cash deposited after the creation of the pledge.

Receivables

When a receivable or a contractual right is transferable, security over the receivables or contractual rights is taken normally by way of secured assignment in favour of the lender. A service of notice of the assignment to the obligor of the receivable or the contractual right is required for perfection. To create a pledge over receivables, the pledgee and the pledgor must enter into a written agreement. In addition, the receivables must be identifiable according to the content of the pledge agreement. Further, the obligor should be notified of the creation of the pledge for the pledgee to be able to claim the pledge against the obligor.

Shares

According to the Company Act, a company limited by shares should issue shares in certificated form if its issued capital reaches the threshold amount specified by the competent authority (currently, NT$500 million or approximately US$15,625,000). In addition, a public company may issue shares in scripless form. To create a pledge over shares in certificated forms, a written agreement is required. The certificates of the pledged shares shall be duly endorsed and delivered by the pledgor to the pledgee. Furthermore, the company issuing the shares shall be notified of the creation of a pledge to register the pledge on the shareholders' roster. The creation of a pledge is valid between the pledgee and the pledgor when the certificates of the shares have been endorsed and delivered to the pledgee. Without a notice to the issuing company, the creation of the pledge cannot be claimed against the company.

To create a pledge over listed shares in scripless form that are traded and transferred through the book-entry system of the Taiwan Depository and Clearing Corporation, the pledgor and the pledgee have to sign a form prescribed by the Taiwan Depository and Clearing Corporation and have the pledge registered with it.

ii Guarantees and other forms of credit support

Guarantor

Under Taiwan law, a guarantor may refuse to perform the guaranteed obligations until the compulsory execution against the property of the borrower proves to be futile (i.e., the lender must seek payment from the principal debtor first); provided, however, that the guarantor may waive (and in practice must waive as required by a lender) this defence (i.e., *beneficium ordinis*) in advance. In practice, a guarantor is normally required to act as a joint guarantor (i.e., jointly and severally liable with the borrower for the loan), so the lender may commence concurrent legal action against both the borrower and the guarantor.

In the circumstance under which the guarantor is not a joint guarantor nor waives the defence of *beneficium ordinis*, the lender must seek payment from the borrower first and the guarantor later. The legal proceeding for the lender to seek payment from the borrower may take months or years. Therefore, there is a risk that before the lender seeks payment from the guarantor, the guarantor may attempt to transfer its assets to others to avoid enforcement by the lender.

Negative pledge

In addition to general negative pledge in the loan agreement, the lender may seek a specific negative pledge from the borrower as provided under the Banking Act. When no collateral is provided to a lender under a financing transaction, the lender may require the board of directors of the borrower to pass a resolution providing a negative pledge undertaking that the borrower will pledge or mortgage its assets in favour of the lender and, before that is done, the borrower shall not pledge or mortgage the same to any third party. If the borrower breaches the undertaking, the borrower's directors or officers who make the decision to breach the negative pledge shall be jointly and severally liable for compensating the lender, and shall be subject to imprisonment for not more than three years, detention or a criminal fine of not more than NT$1.8 million (or both).

iii Priorities and subordination

General principle

Security interests, such as a pledge and a mortgage, will have priority over other claims or rights of the borrower's creditor unless otherwise provided by mandatory provisions of laws. The sale proceeds of the mortgaged or pledged property in a court compulsory execution proceeding will be allocated and distributed in accordance with the following order: (1) expenses paid by the pledgee or the mortgagee for the compulsory execution proceedings; (2) applicable taxes having priority over the security interest under mandatory provisions of laws; (3) statutory security interest; (4) the mortgagee or pledgee of the property; (5) certain labour claims in the event that the employer winds up or liquidates its business or has been adjudicated bankrupt; (6) applicable taxes, if any, having no priority over the security interest; and (7) unsecured creditors.

Subordination agreement

In the case of unsecured financing, the lender in practice would require that the borrower enter into a subordination agreement with the borrower's shareholders or affiliates so that the unsecured loans provided by these persons to the borrower will be subordinate to the loan provided by the lender. Unlike a security interest having priority over unsecured debts of the borrower, the subordination agreement is merely a contractual undertaking from the borrower and its shareholder or affiliate and does not have the effect of priority preferred by law.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Limitations for foreign companies on taking security

Article 12 of the Law Governing the Application of the General Principles of the Civil Code provides that a foreign legal person, upon being recognised, will have, to the extent as provided by laws and regulations, the same capacity to enjoy rights as a legal person in Taiwan of the same type. To the extent that it is not recognised in Taiwan, the foreign legal person might not enjoy the same rights as a legal person in Taiwan of the same type. In addition, according to a letter issued by the Ministry of Economic Affairs dated 1 September 1997, a foreign company that does not have a branch in Taiwan is not entitled to the rights of a pledge or mortgage.

Notwithstanding the above, in connection with aircraft financing, the Civil Aeronautics Administration (CAA) has been of the opinion for decades that aircraft can be validly mortgaged to a foreign legal entity without having a branch office in Taiwan. Moreover, the Harbour Bureau customarily will permit a foreign lender without a branch in Taiwan to be registered as a mortgagee in connection with ship financing. The opinions of the CAA and Harbour Bureau are, however, subject to test in court because of lack of precedents.

ii Limitations on lending and making of guarantees

Private company

According to the Company Act, a company shall not lend to any shareholder of the company or any other person except: (1) where an inter-company or inter-firm business transaction calls for such a lending arrangement; or (2) where an inter-company or inter-firm short-term financing facility is necessary, provided that the amount of the financing facility shall not exceed 40 per cent of the amount of the net value of the lending company. In addition, a company shall not act as a guarantor of any nature, unless otherwise permitted by any law or by the articles of incorporation of the company.

Public company

In addition to the restriction provided in the Company Act, a public company should adopt internal rules in accordance with the Regulations Governing Loaning of Funds and Making of Endorsements or Guarantees by Public Companies. The internal rules must set forth the rules and guidelines a company should follow in making loans or providing guarantees. For example, a public company may not make endorsements or guarantees for other companies except for (1) a company with which it does business; (2) a company in which the public company directly and indirectly holds more than 50 per cent of the voting shares; or (3) a company that directly and indirectly holds more than 50 per cent of the voting shares in the public company. Moreover, companies in which the public company holds, directly or indirectly, 90 per cent or more of the voting shares may make endorsements or guarantees for each other, and the amount of endorsements or guarantees may not exceed 10 per cent of the net worth of the public company, provided that this restriction shall not apply to endorsements or guarantees made between companies in which the public company holds, directly or indirectly, 100 per cent of the voting shares.

iii Financial assistance

Financial assistance generally refers to assistance provided by a target for the acquisition by a third party of shares in the target, by advancing funds, making loans or providing security. Generally speaking, the provision by the company of financial assistance in this context is subject to restrictions under Taiwan law. As mentioned above, there are prohibitions and restrictions regarding the loans or guarantees provided by a company. The provision of security other than a guarantee generally will be deemed as providing a guarantee as well and is subject to the same restrictions.

iv Choice of a foreign governing law

Generally, the choice of a foreign governing law to govern a contract (e.g., the loan agreement) would be recognised as a valid choice of law and given effect by the courts of Taiwan, provided that the relevant provisions of the foreign governing law would not be applied to the extent the courts hold that: (1) the application of the provisions would be contrary to the public order or good morals of Taiwan; or (2) the provisions would have the effect of circumventing mandatory or prohibitive provisions of Taiwan law. However, where the contract is about the creation or perfection of a security interest, such as a pledge and mortgage, the choice of law will be subject to the law of Taiwan regarding conflicts of law. As a general rule, if the property is located in Taiwan or if the rights subject to the security interest arise from Taiwan law, such as the shares in a Taiwan company, the law of Taiwan on conflicts of law will refer to Taiwan law as the governing law.

VI LOAN TRADING

i Performing loans

According to a ruling issued by the FSC, a bank generally shall not transfer its performing loans to others unless meeting any of the following exceptions: (1) the bank obtains consent from the borrower; (2) the bank transfers its loan to other financial institutions pursuant to the Financial Institutions Merger Act or the Financial Asset Securitisation Act; or (3) the bank has a special need to do so, such as for refinancing purposes. If the bank violates the above restrictions, it may be deemed as violating the principle of good faith and according to Subparagraph 2 of Paragraph 1 of Article 294 of the Civil Code, the transfer may be invalid. Furthermore, the bank may be deemed as violating its confidentiality obligations under the Banking Act.

ii Non-performing loans

According to the Directions Governing the Sale of Non-Performing Loans by the Financial Institutions, in general the financial institutions shall collect the debts themselves; provided however, that a financial institution may sell its non-performing loans when the ratio of the non-performing loans of the financial institution exceeds a certain percentage (currently 3 per cent); or, if less than 3 per cent, the non-performing loans are syndicated loans; loans extended by offshore branches or offshore banking units of the financial institution; or loans extended to construction companies.

VII OUTLOOK AND CONCLUSIONS

In the first quarter of 2017, the total amount of syndicated loans in the Asia-Pacific market (excluding Japan) was US$59.4 billion, down 46 per cent from the first quarter of 2016. The syndicated loan markets in China, Hong Kong, Australia and South East Asia also declined. Taiwan was also affected by this weak economic performance, but the syndicated lending decline in Taiwan was relatively small, as easier funding conditions for the lenders in Taiwan helped prevent a decline in deal volumes.

Against the above background, because the P2P lending platform provides a more convenient and efficient channel for lending money and investing, and allows different kinds of borrowers to utilise more flexible lending amounts; it has been going strongly recently. Furthermore, as the regulator remains open-minded about this emerging channel, it may have an impact on the traditional financial industry, especially the banks.

Chapter 23

UNITED STATES

Monica K Thurmond and Eric J Stoller[1]

I OVERVIEW

The current US corporate lending market is sophisticated, extremely large and highly varied, having numerous types of borrowers, loan products and lenders. According to Thomson Reuters LPC, there was an aggregate of approximately US$2 trillion of loans issued to corporate borrowers in the United States in 2016, with leveraged loans accounting for approximately US$875 billion. Borrowers span every industry, and the loan markets they can access depends in large part on their capitalisation and credit profile. Loan products span from unsecured revolving credit facilities for investment grade companies and widely syndicated covenant-lite term loan facilities for large cap leveraged loan borrowers to more traditional 'club deal' senior secured credit facilities for middle market borrowers (generally defined as borrowers with less than US$500 million in annual sales or less than US$50 million in earnings before interest, taxes, depreciation, and amortisation (EBITDA)). Lenders include traditional banks, finance companies, and institutional investors such as collateralised loan obligations (CLOs), hedge funds, loan participation funds, pension funds, mutual funds and insurance companies.

In general, loan issuance volume has remained relatively high in recent years, although there has also been increased volatility. The US loan market continues to experience adjustments for a tightening regulatory environment – in particular, the leveraged lending guidelines issued by federal regulators in March 2013, which were further clarified in November 2014 by a FAQ issued on the guidance, as well as annual Shared National Credit Review reports providing commentary on compliance with the guidance, seem to be continuing to have a strong influence on the loan markets.

Leveraged loan issuance levels related to M&A decreased significantly during 2016. Thomson Reuters LPC noted that leveraged loan issuances related to M&A dropped by 18 per cent in 2016, but leveraged buyout (LBO) activity (which accounted for approximately one-third of all M&A loan issuances in 2016) was up 20 per cent from 2015. Thomson Reuters LPC also reports a sharp increase in the market share of refinancing activity, as opposed to new-money loans.

Even as loan volumes have decreased from their high in early 2013 and increased regulatory scrutiny is expected to continue, the US leveraged loan market remains relatively favourable for borrowers. For example, the market share of covenant-lite loans, which depend on incurrence-based covenants rather than maintenance covenants, has been increasing

1 Monica K Thurmond is a partner and Eric J Stoller is a practice management counsel at Paul, Weiss, Rifkind, Wharton & Garrison LLP.

consistently since the hiatus during the financial crisis. Other borrower-favourable terms that remain prevalent in the US leveraged loan market include soft-call prepayment premiums, the ability to incur refinancing facilities, the ability to buy back loans in the market on a non-*pro rata* basis, covenant baskets that can grow over time based upon a percentage of adjusted EBITDA or consolidated total assets, and loosened collateral requirements. In addition, many borrowers, especially borrowers owned by large financial sponsors, have been able to take the lead in drafting loan commitments and definitive loan documentation and have obtained committed covenant levels and baskets at the commitment stage.

II LEGAL AND REGULATORY DEVELOPMENTS

In recent years, federal regulators have continued their heightened focus on the US corporate lending market, and leveraged lending in particular. In March 2013, federal regulators issued new leveraged lending guidelines to address concerns that lenders' underwriting practices did not adequately address risks in leveraged lending with appropriate allowances for losses. These guidelines apply to federally supervised financial institutions that are substantively engaged in leveraged lending activities. Lenders noted that a number of the guidelines issued were vague and subjective, including the definition of leveraged lending, the description of underwriting standards and the reporting and analytics requirement. Compliance with the guidelines was required by May 2013, but the full force of their impact only started being felt by the market in 2014, particularly in the fourth quarter. In November 2014, regulators released an FAQ on the guidance, and in their Shared National Credit Report issued the same month, they chastised lenders for non-compliance. Most of the attention concerning federal guidance is focused on their assertion that 'a leverage level […] in excess of 6x Total Debt/EBITDA raises concerns for most industries'. In addition, regulators noted that in most cases before extending leveraged loans, it should be established that a company will be able to fully amortise its senior secured debt or repay at least half of its total debt within five to seven years. Regulators have stated that these guidelines are not intended to establish any bright line tests, but loans that do not meet these guidelines will generally become subject to heightened scrutiny. In addition to contributing to sharp reductions in lending activity in certain segments of the market, this guidance has begun to affect the average debt-to-EBITDA levels, which had consistently climbed in the years leading up to 2014 before dropping and flattening out near the 6.0 mark (average levels were 6.08 times in 2016 and 5.96 times in 2015 for broadly syndicated LBO transactions, according to Thomson Reuters LPC). A recent development casts some doubt on the continued effectiveness of the leveraged lending guidance – according to reports in the press, in April 2017 a United States Senator (Pat Toomey) sent a letter to the Government Accountability Office (GAO) asking whether the guidance is actually a 'rule' that should have been subjected to Congressional review pursuant to the Congressional Review Act. If the guidance is deemed to be a rule for the purposes of the Congressional Review Act, it could require the banking agencies to resubmit the guidance for Congressional approval.

In December 2013, the final Volker Rule was issued, which limits the number of trading and investment activities of banking entities. Banking entities will also be required to comply with extensive reporting requirements in respect of permitted trading and investment activities. The Volker Rule compliance period begins in July 2017, and the reporting requirements became effective in June 2014. In late October 2014, risk retention rules were released that require CLO managers to purchase and hold 5 per cent of the fair value of the liabilities of the CLO, which they may hold through a *pro rata* share of the CLO's notes, a residual interest in the CLO's equity or a combination of both. The rules came into effect in December 2016. The Loan Syndications and Trading Association (LSTA) has argued that the rules will not work for much of the CLO market for structural reasons, and has filed a lawsuit against the Federal Reserve Board and the Securities and Exchange Commission. In December 2016, the federal district court granted summary judgment against the LSTA, but the LSTA has appealed that decision in a proceeding that remains pending.

Federal regulators have also continued to enforce sanctions and anti-corruption and anti-terrorism laws, and have recently reinvigorated their efforts. As a result, and in response to ever increasing fines for violations, lenders have expanded the compliance terms included in credit documentation. These efforts have included broader representations and warranties with fewer materiality and knowledge qualifiers, as well as affirmative and negative covenants that require compliance with sanctions regulations and anti-bribery laws and restrict borrower activities in restricted countries or with restricted entities to the extent that such activities would involve loan proceeds.

US banks also continue to address the Basel III requirements. Basel III requires banks to meet a number of capital requirements to strengthen a bank's liquidity and contain its leverage. Among other things, Basel III requires banks to increase their holdings of Tier 1 capital to at least 7 per cent of their risk-weighted assets to meet additional liquidity and capital requirements. In December 2014, the Federal Reserve proposed that the eight largest US banks should comply with capital requirements that are even more restrictive than those outlined by Basel III, including an additional capital cushion. According to the Federal Reserve, most of the firms should already meet the new requirements, and all are taking steps to meet them by the end of a phase-in period that runs from 2016 to 2019.

III TAX CONSIDERATIONS

The US corporate lending market is subject to various federal tax considerations, most of which can be addressed with careful planning and drafting.

i Tax considerations applicable to US borrowers

The initial determination in any US corporate lending transaction will be whether the debt will be respected as debt for federal income tax purposes or characterised as equity. Interest on debt is generally deductible by the borrower, while dividends are not. Debt terms that raise the question of whether it may be characterised as equity include a long term to maturity (for example, in excess of 30 years), subordination to other instruments in the capital structure, a high debt-to-equity ratio at the borrower, and in some circumstances the right to convert into the stock of the borrower.

Another determination to be made is whether the debt will be treated as giving rise to 'phantom interest' that must be taken into account by the borrower and lender even when no payments are made. In general, a debt instrument sold with original issue discount will result in unstated interest equal to the difference between the issue price and the stated redemption price at maturity, and that interest will be taxed on an economic accrual basis pursuant to the original issue discount (OID) rules. The OID rules also apply to payment-in-kind and similar instruments. The OID rules will not apply if the original issue discount is less than a statutorily defined *de minimus* amount.

Borrowers subject to the US tax laws must also be careful to address the applicable high-yield discount obligation (AHYDO) rules, which substantially restrict interest deductions for debt characterised as an AHYDO. An AHYDO is any debt instrument with a term of more than five years, having a yield that exceeds the applicable federal rate at the time of its issuance by five percentage points or more, and that has 'significant original issue discount'. Debt will have significant OID if, at the end of any accrual period ending after the fifth anniversary of its issuance, the aggregate amount of interest and discount required to be included in income by a holder exceeds the amount of interest and discount actually paid in cash by more than one year's yield on the instrument. AHYDO rules may be avoided by incorporating a savings clause in the loan documentation that requires the borrower to pay the minimum amount of principal plus accrued interest on the loan necessary to prevent the deduction of any of the accrued and unpaid interest and OID from being disallowed or deferred.

US companies are generally not required to pay US taxes on the earnings of non-US subsidiaries unless and until those earnings are repatriated to the United States. The provision of a guarantee or the pledge of assets by a non-US subsidiary to support the loan obligations of a US parent, however, are treated as a repatriation in the amount of the credit support and therefore as taxable income to the US parent. In addition, a pledge by the US parent of two-thirds or more of the voting stock of a non-US subsidiary is considered tantamount to a pledge of that subsidiary's assets, and is therefore deemed to be repatriated earnings. Loan documents in the US will often provide that a non-US subsidiary of the borrower will neither guarantee the loans nor pledge its assets, and the pledge of the subsidiary's voting stock will be limited to avoid these rules.

ii Tax considerations specific to non-US lenders

There are a number of US tax considerations specific to US borrowers and non-US lenders in corporate lending transactions. For example, under the US 'earnings stripping' rules, if a US borrower makes interest payments to a non-US lender and either the lender is an affiliate of the borrower or has received a guarantee from a foreign affiliate of the borrower (such as a parent entity), deduction of interest by the US borrower may be limited or denied.

In addition, if a lender is an offshore fund, then it is not likely to join a syndicate in a US loan transaction until after initial funding has been made by other lenders. This is because doing so could trigger tax filing and payment obligations in the US for the fund or its investors. In contrast, trading in outstanding securities acquired in the secondary market will not result in such obligations.

iii US withholding taxes

In general, the United States does not require withholding tax on interest payments to US lenders, but it will require withholding taxes on interest payments to non-US lenders in the absence of an available exemption. This tax is generally equal to 30 per cent of the gross amount of the payments made to the non-US person, and is required to be withheld by the borrower. Lenders that are otherwise subject to the withholding tax may avail themselves of one of three exemptions to reduce or eliminate this tax:

a the 'portfolio interest exemption';
b treaty eligibility; and
c effectively connected income.

The portfolio interest exemption is available to a non-US person that is not a bank if certain conditions are met, many of which can be satisfied by including certain non-controversial provisions in the loan documentation, together with submission of certain federal tax forms to the borrower certifying that the person is not a US person. In addition, if a non-US lender is resident in a country that has an income tax treaty with the United States, the provisions of the treaty may reduce or even eliminate withholding taxes. Finally, a non-US lender that makes a loan through a US branch that is engaged in a US trade or business will be exempt from US withholding taxes, but not US federal income taxes, on interest payments made by the borrower. Most US loan documentation provides contractual protection against withholding by requiring the borrower to 'gross up' interest payments if withholding becomes payable, although this requirement is often limited to withholding that results from a change in law after the effective date of the credit agreement.

iv Foreign Account Tax Compliance Act

One of the most recent developments in US tax laws affecting non-US lenders is the Foreign Account Tax Compliance Act (FATCA). FATCA requires non-US financial institutions with US customers and non-US non-financial entities with substantial US owners to disclose information regarding the US taxpayers. FATCA became effective on 1 July 2014. If an institution or entity does not comply with FATCA, a 30 per cent withholding tax is triggered, and responsibility for collecting the tax generally falls on the US borrower. The tax is applicable on all payments normally subject to US taxation, such as dividends, as well as to income that is traditionally excluded, such as bank interest and capital gains. Payments of principal will also be subject to FATCA withholding tax beginning as early as 1 January 2017. Borrowers acting as withholding agents that fail to withhold will be subject to financial penalties. As such, loan documentation in the United States now usually requires that a lender must provide information to the borrower upon request to prove compliance with FATCA, and that in any event FATCA withholding obligations will not benefit from any gross-up provisions.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Taking a security interest in assets that are located in the United States is relatively streamlined, and is governed in most instances by Article 9 of the Uniform Commercial Code (UCC). In general, a security interest will attach if the collateral is in the possession of the secured party pursuant to agreement or if the borrower has signed a security agreement that describes the collateral, value has been given and the debtor has a right to the collateral. If all three of these conditions are met, then the security interest 'attaches' and is enforceable. Notably, in the United States a single security agreement can effectively create a security interest in substantially all of the assets of a borrower. However, unless that security interest is 'perfected', it may not come ahead of other security interests taken in the same collateral, and perfection can differ depending on the assets comprising the collateral. Under the UCC, a lender may 'perfect' its security interest in collateral by satisfying the requirements for perfection outlined in the UCC, and once perfected that security interest will take priority over all other security interests that are not perfected or that have been perfected subsequently. It is important to note that each state has adopted variations from the standard UCC, so although they are generally very similar, one should refer to the UCC adopted by the relevant state when taking a security interest.

The most common way to perfect a security interest in assets covered by the UCC is to file a UCC-1 financing statement in the appropriate filing office. The UCC-1 financing statement generally requires the name of the debtor, the name of the secured party or its representative and a description of the collateral. The description can be as general as 'all assets' but will more typically track the description of the collateral found in the related security agreement. UCC filing fees are typically small, and there are few, if any, other costs related to taking security interests in the property covered by UCC filings. For borrowers that are US corporations, limited liability companies or registered partnerships, the appropriate filing offices will be their respective jurisdictions of organisation. For non-US entities that do not have a filing system for perfection in their home jurisdictions (which is most other jurisdictions besides provinces of Canada other than Quebec), the appropriate filing office would be the District of Columbia. Although a UCC-1 filing will serve to perfect most collateral, certain kinds of UCC collateral, most notably deposit accounts and cash, can only be perfected by control or possession, most often by housing the account with the agent or another lender or by entering into a control agreement with the bank where the account is located. In addition, some assets may be perfected by more than one method under the UCC, although one method may be preferable to another. For example, perfection by possession of a stock certificate will take priority over a UCC-1 financing statement that was filed earlier and covers the same stock.

In addition to deposit accounts, cash and stock noted above, there are a number of assets that are governed by special rules relating to perfection and priority or other special considerations. These include, but are not limited to, agriculture; aeroplanes; fixtures; intellectual property; letters of credit; vehicles; oil and gas and other mineral rights; railcars; real property; satellites; ships and warehoused inventory. The laws governing taking security interests in real property, for example, vary from state to state, generally take longer to satisfy, and can involve significant costs. There are often recording taxes and fees imposed by state and local laws, which can be excessive, so lenders sometimes take assignment of mortgages in connection with new financings rather than enter into new ones. Loans secured by mortgages may be limited to the value of the property rather than the amount of the loan to avoid onerous mortgage taxes. To secure interests in intellectual property, such as registered trademarks, copyrights and patents, federal filings will be required that specifically list each item, and these filings must be updated for any property acquired afterwards.

ii Guarantees

Guarantees are commonly provided by parents, subsidiaries and side-by-side subsidiaries of a common parent in the US corporate loan market. In large-cap transactions, parent guarantees are often limited in recourse to the stock of the subsidiary borrower, although this is less often the case in middle market loans. Subsidiary guarantees are typically full and unconditional, but they are often limited to guarantees from domestic subsidiaries to avoid adverse tax consequences to the borrower of a non-US guarantee (discussed in Section III, *supra*), and may be limited to wholly owned domestic subsidiaries. Guarantees may be supported by security interests in the guarantors' assets to the same extent that the loans are secured by the borrower's assets.

iii Priorities and subordination.

There are three primary methods of achieving priority in US corporate lending transactions:

a possessing a prior, perfected security interest in the assets of the borrower or being the beneficiary of an intercreditor agreement establishing priority in liens;

b being 'structurally senior' to the other debt; and

c being the beneficiary of a subordination agreement.

When a lender obtains a first priority perfected security interest in the assets of the borrower in a US loan, the lender obtains the right to receive a priority distribution equal to the proceeds of sale (or value) of that asset to the exclusion of any other creditors (except for holders of certain statutory liens). This means that in the event of a foreclosure, bankruptcy or other liquidation, the secured lender will be entitled to be paid out of the proceeds of the assets securing the loans before any lender having a junior security interest or no security interest in the asset may be paid. Priority in liens is typically established by perfection, as discussed in Section IV.i, *supra*, but it can also be established contractually by an intercreditor agreement. Lenders under a senior secured credit agreement may agree to allow the borrower to incur additional first lien indebtedness or second lien indebtedness and enter into an agreement with the lenders of that indebtedness as to priority in security, as well as to how remedies will be enforced in respect of the collateral, among other things.

While achieving structural seniority in the US corporate loan market, like other markets, depends entirely on lending to a level within the borrower's capital structure that is below the level to which another lender extends credit, contractual seniority is established by a subordination agreement. Contractual subordination is achieved by an agreement in which the subordinating creditor agrees that in the event of a bankruptcy or other distribution of assets of the debtor, any amounts otherwise distributable to the subordinating creditor will instead be paid to a specified creditor or class of creditors holding 'senior debt' until they are paid in full. The class of 'senior debt' is usually defined as all indebtedness for borrowed money whether now existing or incurred hereafter, as well as capital leases. It is not necessary that the subordination agreement be between the subordinated creditor and the senior creditor, and often the senior creditor is the third-party beneficiary of an agreement between the borrower and the subordinating creditor. Subordination terms in the United States also typically provide that if there is a payment default on the senior debt, no payment may be made on the subordinated debt until the default is cured or the senior debt is paid in full. In addition, many subordinated debt provisions state that, in the event of a non-payment default on the senior debt, there will be no payments on the subordinated debt for a specified blockage period, which typically runs between 90 and 180 days. Although subordinated debt issuances were common in the US market in the 1990s, they are relatively rare in the current US corporate loan market.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Legal reservations

There are no financial assistance laws in the United States to speak of, but a federal bankruptcy court can void a guarantee or the pledge of assets by a subsidiary or parent of the borrower if the guarantee is deemed a 'fraudulent transfer', meaning that the guarantor was insolvent at the time of the guarantee or was rendered insolvent and the guarantee and the guarantor received 'less than reasonably equivalent value' for the guarantee. Given that both aspects of this test must be met for a guarantee to be deemed a fraudulent transfer, as long as a guarantor is solvent at the time of the guarantee, it does not have to receive equivalent value. Most states have similar fraudulent transfer laws, which can also be applied by the bankruptcy court to void the guarantee. This is less of a concern for parent guarantees than subsidiary guarantees, as a parent is typically deemed to have benefited from the loan to its subsidiary through its equity ownership.

ii Opinions practice

In the United States, it is typically the borrower's counsel that provides a legal opinion in respect of loans to the loan arrangers or agent on behalf of the initial lenders. The opinion will usually cover the authority of the obligors to enter into the loan documents, the execution and delivery of the loan documents by the obligors, the enforceability of the loan documents, conflicts with laws, organisational documents and material agreements and the creation and perfection of security interests in collateral that may be perfected by filing a UCC-1 financing statement, possessory stock pledges, and sometimes collateral consisting of real estate, intellectual property or deposit and securities accounts. Depending on the jurisdictions in which the borrower and the guarantors are organised, there may be opinions as to authorisation, execution and delivery of loan documents, as well as to conflicts with organisational documents and perfection, by various local counsel.

iii Choice of law and enforcement of foreign judgments

In general, courts in the United States recognise choice of law provisions in contracts (sometimes subject to the requirement that the choice of law has a substantial relationship with the contract and the transactions contemplated by the contract) so long as the application of the chosen law would not be contrary to a fundamental policy of another jurisdiction with a materially greater interest in the determination of a particular issue and the application of the chosen law would not threaten public policy or violate any fundamental principle of justice. Similarly, US courts will enforce final judgments of foreign jurisdictions so long as, among other things, the judgments were rendered under systems that provide impartial tribunals and procedures compatible with the requirements of due process of law, the other court had personal jurisdiction and jurisdiction over the subject matter, and the cause of action was not repugnant to public policy.

VI LOAN TRADING

In the United States, loan trades are either made by assignment or participation. Lenders typically trade in syndicated loans over the dealer desks of the large underwriting banks. In assignments, an investor becomes a party to the loan documents and participates as a 'lender' under the loan documents, including with respect to voting rights. As such, assignments are typically subject to a minimum threshold and will require the consent of the administrative agent and the borrower, which may not be unreasonably withheld. Upon an event of default, which is sometimes limited to payment and bankruptcy defaults, a borrower will lose its consent right. Investors may also purchase participations by entering into a participation agreement with a lender to take a participating interest in that lender's commitment. The selling lender remains the holder of the loan. Consents are rarely required, and the participant has the right to vote only on items such as the rate, terms and release of all or substantially all of the collateral. Guarantees and security are granted to the administrative agent on behalf of all of the lenders, present or future, so new lenders benefit from them to the same extent as if they had been part of the original syndicate without the need for the guarantor to sign or otherwise approve the transfer documentation. Loan derivatives common in the US corporate loan markets include loan credit default swaps (LCDS), in which the seller is paid a spread in exchange for agreeing to buy a loan at par, or some other pre-negotiated price. In the event that the loan defaults, the LCDX, an index of 100 LCDS obligations that are traded over-the-counter, and total rate of return swaps, in which a purchaser buys the income stream from a loan with a 10 per cent down payment that serves as collateral and a loan from the seller and is obligated to purchase the loan at par or cash, settle the position upon a default.

VII OTHER ISSUES

As briefly discussed above, many of the current trends in the US corporate loans market are borrower-favourable terms that were popular at the height of the economic boom in 2006–2007. When these features largely disappeared from the market during the financial crisis, many believed it would be several years before these terms would return, yet these terms are again becoming widely available to borrowers. In the current market, borrowers negotiating credit agreements have been aggressive in testing the limits of what the market will bear.

i Covenant-lite

Covenant-lite deals remain a strong part of the US leveraged loan market. Some covenant-lite deals contain no financial covenants, but otherwise resemble traditional credit agreements. Other covenant-lite loans, in addition to lacking maintenance covenants, also have high-yield style incurrence tests allowing unlimited debt, liens and acquisitions upon *pro forma* compliance with applicable incurrence ratios, as well as restricted payments, investments or payment of junior debt subject to grower baskets based increasingly on a percentage of adjusted EBITDA. In a growing number of covenant-lite deals, asset-based lending (ABL) structures are becoming more common, with a stand-alone term loan lacking maintenance covenants, and a stand-alone ABL revolver having a 'springing' fixed charge coverage ratio tested only if borrowing availability falls below a specified level. In these structures, term loans usually have cross-acceleration to the ABL, rather than cross-default, which prevents the term lenders from indirectly benefiting from the ABL's financial covenant. In addition, ABL financial covenants have trended toward higher thresholds before testing is triggered, excluding outstanding letters of credit for purposes of testing the trigger and setting covenant levels at higher cushions over the financial model for the borrower.

In instances where there is a cash flow revolver instead of an ABL, the covenant-lite documentation has typically contained a financial covenant that applies only to the revolver, and, in many cases, only if the revolver exceeds a specified threshold of outstanding borrowings. Breach of the financial covenant will not result in a breach of the term loan, or will only result in a breach of the term loan if the revolving lenders have not waived the default by the end of a 45 to 90 day standstill period. Until the expiration of the standstill, the revolving lenders will have exclusive rights to waive or amend the financial covenant or exercise remedies in respect of the breach.

ii Convergence of leveraged loans and high-yield markets

There is a continued convergence in the US leveraged loan and high-yield bond markets, resulting in term loan B facilities with high-yield style terms. Trends contributing to this convergence include the tendency for the same company to raise capital in both the leveraged loan and high-yield bond markets, a switch by loan arrangers to a fee-based business model, shifting the emphasis from holding loans to syndication and trading, and the increasing influence in the loan market of institutional investors, hedge funds and other investors familiar with the covenant structure of the bond market. High-yield style terms being adopted in the loan market include incurrence-based covenants and builder baskets as discussed above, as well as greater refinancing flexibility.

iii Refinancing facilities

In addition to incremental facilities, which have been common to US loan agreements for some time, credit agreements in many large cap deals now include refinancing facilities. Refinancing facility provisions permit the borrower to refinance a portion of its existing credit facility either with new tranches of loans under the credit agreement or additional debt incurred outside the credit agreement. Debt incurred outside the credit agreement may be secured on a *pari passu* basis or by junior liens, in each case subject to an intercreditor agreement. This development allows the borrower to refinance loans with debt that is outside the credit agreement but still shares in the collateral, without requiring the consent of the lenders. Unlike incremental facilities, refinancing facility provisions rarely contain most favoured nation provisions affecting pricing.

iv Soft calls

If a prepayment premium is included for term loans in a large-cap deal, and even in some middle market transactions, it now tends to be a 'soft call', meaning it is only payable if there is a 'repricing event'. Repricing events occur when there is a refinancing at a lower interest rate or an amendment to reduce the interest rate. The soft call is typically priced at 1 per cent of the amount refinanced or repriced in the first six months or first year of the loan. Some loans contain exceptions for refinancings where the primary purpose is not repricing, such as change of control transactions, qualifying initial public offerings and transformative acquisitions.

v Stronger commitment terms

In underwritten financings, borrowers with strong market power, including portfolio companies of strong equity sponsors, have been successful in obtaining committed financial covenant levels and agreement upon detailed financial definitions in the term sheet stage. Increasingly, other significant terms once reserved for negotiation in the definitive loan documentation are being agreed upfront in the commitment papers, including material debt and lien baskets, restricted payment carveouts, builder baskets and other negative covenant carveouts. In many cases these borrowers have controlled the commitment documentation, often using the sponsor's 'form', and requiring the committing lenders to agree to a prior sponsor precedent as the guiding documentation for all items not specified in the term sheet.

vi Loosened collateral requirements

Commitment letters have started relaxing the scope of the collateral requirements that need to be satisfied at closing. They have begun to allow lien searches (sometimes excluded UCC liens) to be included in the list of items that can be delivered post-closing, and they have limited perfection of collateral at closing to those items that may be perfected by the filing of UCC-1 financing statements and to the delivery of certificated securities of US subsidiaries only, or even material US subsidiaries only. Large-cap deals now often eliminate the requirement for bank account control agreements, except in the ABL context, and an expansive list of excluded collateral has become standard, including excluding owned real estate valued below a specified threshold, all leaseholds, non-US collateral, assets securing receivables financings and any liens resulting in adverse tax consequences, among others.

VIII OUTLOOK AND CONCLUSIONS

The market for US loans remains relatively strong, in part because of a relatively strong US economy, a strong US dollar and the potential for modest increases in federal interest rates within the next year. At the same time, loan supply has been dampened somewhat by an increase in regulatory constraints. With demand remaining strong, this could mean that qualified borrowers will continue to wield significant leverage when negotiating loan terms. In addition, the market has been adjusting, and should continue to adjust, to the new regulatory environment, with non-bank lending filling some or most of the void created by the constraints on the banks to make leveraged loans that do not fit within the regulatory guidelines. With that said, the impact that the inability to borrow will have on companies that do not meet the lending criteria and cannot find alternative lending sources, as well as on the US loan market, generally, remains to be seen, especially for those seeking to refinance already bloated capital structures.

Appendix 1

ABOUT THE AUTHORS

JEAN E ANDERSON

Goodmans LLP

Jean E Anderson is a partner in the banking and finance law group at Goodmans. Her practice focuses on financing, corporate transactions and regulatory matters. With more than 30 years of extensive expertise in the areas of project finance, structured finance, asset-based lending, debt restructuring, complex domestic and cross-border financings and regulatory matters relating to financial institutions, she is recognised as a leading practitioner of banking and finance law by *Chambers Global*, Euromoney's *Expert Guide: The Legal Media Group Guide to Banking Lawyers* and *Expert Guide: The Legal Media Group Guide to Women in Business Law*, *IFLR1000*, *Best Lawyers in Canada* and Law Business Research's *Who's Who Legal: Banking*. She is recognised for asset-based lending and banking by *The Canadian Legal Lexpert Directory*, *The Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada* and *The Lexpert Guide to Leading US/Canada Cross-Border Corporate Lawyers in Canada*. In addition, she was recently named *Best Lawyers* 2015 Toronto Asset-Based Lending Practice Lawyer of the Year and recognised as a leading infrastructure lawyer in Canada by *Lexpert*. She also received the 2009 Lexpert Zenith Award, recognising her as one of Canada's leading female lawyers. She formerly served as a law clerk to the Chief Justice of the Ontario Court of Appeal, and was admitted to the Ontario Bar in 1981.

BLANCA ARLABÁN GABEIRAS

Uría Menéndez Abogados, SLP

Blanca Arlabán Gabeiras is a lawyer in the banking and finance practice area. She joined Uría Menéndez in 2007. Between March and September 2010, Blanca worked in the London office of Slaughter and May, where she was an international secondee in the banking and financing team. Blanca has worked in the London office of Uría since January 2014. In 2016, she was seconded to Goldman Sachs International in London for six months.

In her professional practice, Blanca focuses mainly on financing, restructuring, mergers and acquisitions and general commercial law.

Blanca has advised on some of the most complex and innovative financing and restructuring transactions in Spain in recent years, including the largest international restructuring (by value) completed in Spain, one of the largest of its kind in Europe. Blanca's experience of cross-border financing transactions is extensive, and she has recently advised on a number of asset and corporate financing transactions as well as various distressed debt and real estate portfolio acquisitions. She advises a wide range of clients, including corporates, financial institutions and funds and is highly accustomed to working with international as well as domestic clients.

Blanca has been an assistant professor at lectures on the master's degree programme at the Universidad Privada de Navarra and has spoken at various seminars in her field.

TARO AWATAGUCHI

Anderson Mōri & Tomotsune

Taro Awataguchi is a partner at Anderson Mōri & Tomotsune. He studied at Waseda University (LLB) and is admitted to the Bar in Japan. He is well-experienced in asset-based lending and other types of secured finance transactions. He also has extensive experience in representation of creditors, debtors and sponsors in cross-border and domestic insolvency cases.

BRUNO BALDUCCINI

Pinheiro Neto Advogados

Bruno Balduccini has been a partner since 2001 in the corporate area of the Pinheiro Neto Advogados office in São Paulo. His fields of expertise are banking regulations, business law, corporate law, financing, investments, M&A, exchange controls, credit cards, insurance and reinsurance. In addition to his practice in Pinheiro Neto Advogados, he has been a standing member of the São Paulo Lawyers Institute since 2004, where he participates in the banking law committee.

Mr Balduccini graduated with an LLB from the Pontifical Catholic University of São Paulo (1992), and holds a master's degree in international banking law from Boston University (1998). He was admitted to the Brazilian Bar Association in 1993.

Mr Balduccini was a foreign associate at Sullivan & Cromwell in New York for one year between 1998 and 1999.

CHARLOTTE BONSCH

Bredin Prat

Charlotte Bonsch is an associate in the financing team. She is admitted to the New York Bar and the Paris Bar and is a graduate of Whittier Law School, California, United States (LLM 1998) and Panthéon-Assas University (Paris II) (2006).

JOHN BRESLIN

Maples and Calder

John is a partner in the finance department of Maples and Calder, Dublin. John is the author of *Banking Law* – the first ever text on the subject in Ireland. It continues to be the leading text in the area and is now going into its fourth edition. John advises banks and other financial institutions on transactional and regulatory issues. John has acted for banks in leading funds-based financings, and advises clients on all aspects of banking and insolvency law. John is also the head of Maples' advocacy group.

DAVID BURKE

Maples and Calder

David is an of counsel in the tax department of Maples and Calder, Dublin. David advises on international financial transactions structured in and through Ireland. David works with companies, banks and investment funds and their advisers to structure and implement capital markets, structured finance and asset finance transactions.

FRANÇOIS-GUILLAUME DE LIEDEKERKE

Allen & Overy

François-Guillaume de Liedekerke is a counsel at Allen & Overy in Luxembourg. He advises on international banking and finance transactions, acquisition finance, real estate finance, cross-border insolvency and debt restructuring, and regulatory matters relating to the financial services industry. He is the author of a number of publications and he is a member of the editorial committee of the *Revue Luxembourgeoise de Bancassurfinance*.

CAROLINE DESCOURS

Goodmans LLP

Caroline Descours is a partner in the corporate restructuring group at Goodmans. She practises in the areas of commercial insolvency, corporate restructuring, corporate law, bankruptcy and financial services. Caroline has been involved in significant Canadian, cross-border and transnational commercial, insolvency and restructuring matters. Her experience includes recapitalisations, acquisitions, commercial financing transactions, receivership proceedings and corporate and insolvency restructurings. Her roles include acting as counsel for debtors, secured and unsecured lenders and bondholders, and monitors. Caroline has acted for key parties in several complex matters including, among others, the restructurings of Cinram International Inc, Sino-Forest, Mobilicity, Jaguar Mining, Nelson Education, Postmedia and Rubicon Minerals. She was admitted to the Ontario Bar in 2010.

MATHIEU FRANÇON

Bredin Prat

Mathieu Françon is a counsel specialising in banking and financial regulation. He holds a law degree from the University of Nancy, and a degree in banking risk and regulation from New York University. He is admitted to the Paris Bar.

FREDRIK GILLGREN

Hamilton Advokatbyrå

Fredrik Gillgren is a banking and finance partner in Stockholm. Fredrik specialises in various types of domestic and cross-border finance transactions, primarily leveraged acquisition finance transactions, real estate financing and financial restructurings.

ERIC HALVARSSON

Hamilton Advokatbyrå

Eric Halvarsson is a partner in the banking and finance department in Stockholm. He has particular experience in domestic and cross-border leveraged finance transactions and debt restructurings. Eric has acted for direct lending funds, corporate borrowers and private equity sponsors on senior and subordinated facilities and other structured finance products as well as for issuers and lead arrangers in connection with debt capital market transactions. He is a member of the Swedish Bar Association and admitted as a solicitor of England and Wales.

WATARU HIGUCHI

Anderson Mōri & Tomotsune

Wataru Higuchi is a partner at Anderson Mōri & Tomotsune. He studied at Hitotsubashi University (LLB) and Columbia Law School (LLM) and is admitted to the Bar in Japan and New York. He has particular expertise in asset-based finance, syndicated loans, securitisation and other structured finance transactions.

LEOPOLD HÖHER

Wolf Theiss Rechtsanwälte/Attorneys-at-Law

Leopold Höher is a counsel in the Wolf Theiss practice group banking and finance. He specialises in financing and capital market transactions with a focus on advising national and international clients on domestic and cross-border structured debt financing transactions (in particular, project financings, acquisition financings and corporate lending), secured finance transactions, restructuring transactions and issuance of bonds. Before joining Wolf Theiss, Leopold worked at the Vienna and Prague offices of one of the major law firms in Austria. He has extensive experience as counsel to lenders and arrangers as well as debtors and issuers in Austria and CEE. Leopold completed his studies at the University of Vienna (Mag. iur. 2005) and is the author of various publications on selected issues of Austrian banking and capital markets law.

PATRICK HÜNERWADEL

Lenz & Staehelin

Patrick Hünerwadel has been a partner at Lenz & Staehelin since 1994, where he heads the banking and finance practice group of the Zurich office.

He is an expert in syndicated banking finance, project finance, structured finance and lease finance, asset securitisation, derivatives and regulatory matters.

Patrick is a lecturer on corporate law and contracts at the University of St Gallen. He also serves as co-chairman of the banking law practice group of the Zurich Bar Association.

AURÉLIEN JOLLY

Bredin Prat

Aurélien Jolly is a counsel in the financing team. He was admitted to the Senior Courts of England and Wales in 2005 and to the Paris Bar in 2012. He graduated from Panthéon-Assas University (Paris II) (Licence in Law 1998; Maîtrise in English law 1999) and from Pembroke College, University of Oxford (BA, honours, in jurisprudence 2001; BCL 2002).

GEORGE N KERAMEUS

KPP Law Firm

George is a member of the Athens Bar Association and has been admitted before the Supreme Court and the Council of State. After commencing his career within the tax department of one of the Big Four multidisciplinary firms, he joined a prominent Greek law firm, where he was the tax partner before he left to found KPP Law.

George advises Greek and foreign banks in their capacity as creditors in the framework of all types of lending and other financial transactions, but also Greek banks when receiving financing or protection from, as well as granting security to, foreign banks and international organisations. He further advises all Greek systemic banks in numerous debt-restructuring transactions with large Greek corporates.

He has been recommended in *Chambers & Partners* for banking and finance in Greece.

George is also a tax expert, focusing on corporate tax advice, both on a day-to-day and transactional basis, with great experience in all direct and indirect tax issues, whereas he has also acted on behalf of corporate clients as the lawyer in charge of legal due diligence within the framework of M&A transactions.

DHANANJAY KUMAR

Cyril Amarchand Mangaldas

Dhananjay is a partner at Cyril Amarchand Mangaldas and joined the firm (erstwhile Amarchand & Mangaldas & Suresh A Shroff & Co) in 2006. Dhananjay is registered with the Bar Council of Maharashtra & Goa, India.

He is a part of the financing team and regularly advises leading banks and financial institutions as well as developers on aspects of debt restructuring, security enforcement, project development and structured financing. His areas of specialisation also include restructuring of stressed assets.

He is advising leading banks and asset reconstructions companies in cases under the Insolvency and Bankruptcy Code, 2016.

He is also a fellow of INSOL International.

PETER LAKE

Slaughter and May

Peter Lake is a partner in Slaughter and May's Hong Kong office. He moved from the firm's London office to Hong Kong in 2002 and is involved in a wide range of banking, finance, regulatory and corporate work, advising companies, financial institutions and fund management groups.

Peter is a member of the APLMA Documentation Committee and is listed in the 2017 edition of *Who's Who Legal Banking: Finance* in Hong Kong, and as a leading lawyer in the *IFLR 1000 Asia Pacific 2017* for banking and finance in Hong Kong. He is recommended in the *Legal 500 Asia Pacific 2017* for banking and finance and investment funds in Hong Kong, and in *Chambers Asia-Pacific 2017* for banking and finance, and financial services: non-contentious regulatory (Hong Kong-based international firms, China).

Peter read law at Emmanuel College, Cambridge, and is qualified to practise Hong Kong and English law.

DAVID LEDERMANN

Lenz & Staehelin

David Ledermann is an expert on corporate law, M&A and financing transactions. He also advises in private equity, investments, contract and commercial law.

David joined Lenz & Staehelin in 1999 and became a partner in 2007. He studied at the University of Geneva and at the Duke University School of Law (LLM).

PEDRO RAVINA MARTÍN

Uría Menéndez Abogados, SLP

Pedro Ravina is a partner in the banking and finance practice area of the Madrid office. He joined the Madrid office of Uría Menéndez in 2004. In 2008 he was seconded to the in-house legal department of JP Morgan Securities Ltd in London for four months, and from October 2010 to October 2012 he was based in our London office. From October 2013 to April 2014, Pedro was seconded to the New York headquarters of Wachtell, Lipton, Rosen & Katz.

His practice is focused on banking and finance, M&A deals (in particular, with financial entities), capital markets and corporate restructuring transactions.

Pedro has been involved in a number of investment and divestment projects in listed and non-listed companies, as well as in corporate and project finance transactions and corporate restructuring processes, advising mainly financial entities and private equity firms.

He regularly advises on regulatory aspects concerning financial activities (e.g., banking, investment services and payment services) and undertakings for collective investment. Pedro has acted for Spanish management companies and international investment banks in bond and mortgage security issuances (mainly covered bonds), as well as mortgage-backed and asset-backed securitisations, and other domestic and multi-jurisdictional structured finance deals.

KATHRINE MELONI

Slaughter and May

Following more than a decade as a practising lawyer in London and Singapore, in 2005 Kathrine moved into her current role, providing support to the financing practice at Slaughter and May on technical issues, including legal and regulatory developments and market documentation. She has a particular focus on investment-grade lending, advising the Association of Corporate Treasurers on documentation discussions with the Loan Market Association. Kathrine has published numerous articles on banking and related legal topics and is the co-author of *The ACT Borrower's Guide to LMA Loan Documentation for Investment Grade Borrowers*.

RICARDO SEABRA MOURA

VdA Vieira de Almeida

Ricardo Seabra Moura obtained his law degree at the University of Coimbra Faculty of Law and his postgraduate degree in taxation at ISG Business and Economics School, Lisbon. He also completed the international course 'Practical Aspects of International Tax Planning' at IBFD, Amsterdam.

Ricardo is a managing associate in the tax law practice group. In this capacity, he provides regular tax assistance in the insurance area and has been involved jointly with lawyers of the firm's banking and finance department in several transactions, in Portugal and cross-border, in relation to equity, classic and innovative debt instruments, securitisation transactions and project finance loans. He also provides regular assistance (including setting up) to investment collective undertakings and related investors.

DAVID NADLER

Goodmans LLP

David Nadler is a partner in the banking and finance law group at Goodmans. His practice focuses on financing and corporate transactions. He represents leading Canadian and foreign banks and non-bank lenders and debtors in complex domestic and cross-border syndicated lending transactions, and has been involved in several debt restructurings representing creditors and debtors. He also practises with Goodmans' hospitality law group, representing owners and operators of hotels. He is recognised as a leading practitioner of banking and finance law by Lexpert, Euromoney's *Expert Guide: The Legal Media Group Guide to Banking Lawyers* and *Best Lawyers in Canada*, and has been recognised by *Chambers Global* and *IFLR1000*. He was admitted to the Ontario Bar in 1993.

AZADEH NASSIRI

Slaughter and May

Azadeh is a partner in the London office of Slaughter and May. She has a broad financing practice covering, among other things, investment-grade lending, as well as acquisition and leveraged finance transactions, and has advised on a number of complex, cross-border deals.

ROBERTO PANUCCI FILHO

Pinheiro Neto Advogados

Roberto Panucci Filho is an associate in the corporate area of the Pinheiro Neto Advogados office in São Paulo. His fields of expertise are banking and insurance regulation, financing, M&A, corporate law, business law and foreign exchange controls. He also has a strong background in corporate and commercial litigation.

Mr Panucci earned his bachelor's degree (LLB equivalent) from the University of São Paulo (2008) and holds a master's degree in contract law from the University of São Paulo (2014) and an LLM from Columbia University (2015). He was admitted to the Brazilian Bar Association in 2009.

Mr Panucci was a foreign associate at Paul, Weiss, Rifkind, Wharton & Garrison LLP in New York for one year between 2015 and 2016.

ÁNGEL PÉREZ LÓPEZ

Uría Menéndez Abogados, SLP

Ángel Pérez López is a partner in the banking and finance practice area of the Madrid office. Ángel joined Uría Menéndez in 2000 after working as a financial analyst for a leading Spanish corporate finance firm.

Ángel focuses his practice on corporate, acquisition and project finance. He has worked on some of the most important financing deals that have taken place in Spain in recent years. He advises lenders and borrowers on transactions in the energy, biofuel, waste treatment and telecommunications sectors. He has also advised creditors and debtors on restructuring the debt of some of Spain's biggest companies. Since 2011, Ángel has also participated in several sales and acquisitions of non-strategic assets of financial institutions, such as non-performing loans, real estate assets and property management platforms.

From September 2007 to March 2008, Ángel was seconded to the New York headquarters of the US firm Debevoise & Plimpton, LLP, where he worked in the Acquisition Finance Group as an international associate.

Over the past few years, Ángel's expertise in banking and finance, project finance and restructuring has been recognised by prestigious legal directories such as *Chambers Global*, *Chambers Europe*, *IFLR 1000*, *Who's Who Legal* and *Best Lawyers in Spain*. In the 2015 edition of *Iberian Lawyer* he was named one of the top 40 lawyers under the age of 40 in Spain and Portugal.

ANAÏS PINTON

Bredin Prat

Anaïs Pinton is an associate in the tax team. She graduated from Panthéon-Assas University (Paris II) (2013) and from Paris Dauphine University (2012). She is admitted to the Paris Bar.

INDRA PRAWIRA

Rahayu & Partners Law Offices

Indra Prawira is an associate at Rahayu & Partners. He is a graduate of the Faculty of Law of the University of Indonesia, majoring in economic law. He also attended a postgraduate programme of international law and financial markets at the University of East London (United Kingdom). He is admitted to the Indonesian Bar Association (PERADI) to practice law in Indonesia. Prior to joining Rahayu & Partners, he worked for reputable law firms in Jakarta as an associate. He focuses his practice on general corporate and commercial matters, mergers and acquisitions, projects and corporate finance.

KATHRYN PSILLIDOU

Kannava, Kitromilidou & Co LLC

Kathryn graduated from the Metropolitan University of Manchester with an LLB (Hons) degree in law and, after having attended the Bar Vocational Course at the Inns of Court School of Law, she was called to the Bar by Gray's Inn. She started her career at the Law offices of Cacoyannis & Co plc and then spent seven years at the bank London Forfaiting Asia Ltd, where she set up and headed the legal department. She then spent four years at the Law offices of Chrysses Demetriades & Co in the shipping finance department. She subsequently joined Kommunalkredit International Bank Ltd where she set up the legal department. She spent five years there and held the position of head of the legal department's loans and financing desk. She is now an advocate/partner at KPK Legal, of which she is one of the founding partners. Her areas of practice include banking law with a specialisation in international and public financing, corporate law, commercial law, shipping/maritime law, real estate law and employment law. She is a member of the Cyprus Bar Association and of the English Bar.

SRI H RAHAYU

Rahayu & Partners Law Offices

Rahayu obtained her law degree in transnational and diplomatic law from the Padjadjaran University, Indonesia (1995) and master of laws degree (LLM) in Banking and Finance Law from the London School of Economics and Political Science (LSE), London, England (1999).

Rahayu has practised law at prominent corporate law firms, such as Ali Budiardjo Nugroho Reksodiputro and Hadiputranto, Hadinoto & Partners (the Baker McKenzie member firm in Indonesia), advising domestic and international clients on a wide range of projects, and specializing in banking and finance matters. She has worked with major banking organisations, such as the Hongkong and Shanghai Banking Corporation Limited (HSBC), Citibank, N A Indonesia (Citigroup), PT Bank Permata Tbk, PT Barclays Bank Indonesia (a subsidiary of Barclays Bank PLC), and PT Bank Ekonomi Raharja Tbk (a member of the HSBC Group). At Rahayu and Partners, Rahayu was involved in a broad range of transactions, including foreign investments, projects and corporate finance, mergers and acquisitions, general corporate commercial and dispute resolution. Rahayu is a seasoned advocate, a member of the Indonesian Advocate Association (PERADI) and a capital market lawyer, registered at and a member of the Indonesian Association of Capital Market Legal Consultants (HKHPM). Rahayu holds Indonesian Risk Management Certification (BSMR). She is also an authorised sworn translator. An accomplished writer, she has contributed to several publications, including the International Financial Law Review (IFLR) *Banking Yearbook on Indonesia* (2002).

Rahayu received the British Chevening Award from the Foreign and Commonwealth Office of the United Kingdom (1998). She is also certified in enterprise risk governance (CERG) as established and certified by the Enterprise Risk Management Academy (ERMA) with the professional designation of CERG. CERG is recognition of their expertise and knowledge in ISO 31000. Currently, she is chairperson of the Indonesian Alumni of the London School of Economics and Political Science (LSE), London, England.

RAFFAELLA RICCARDI

BonelliErede

Raffaella Riccardi is a managing associate in the tax department of BonelliErede. Raffaella has a particular focus on the tax issues related to banking and finance transactions and operates from the law firm's Rome office.

JEAN-MARC ROVERS

De Brauw Blackstone Westbroek

Jean-Marc Rovers has a broad (loan) finance practice. In addition to general banking and finance transactions, he specialises in both leveraged and investment grade refinancings as well as in acquisition and project finance. Jean-Marc has extensive experience in the drafting and negotiation of all types of facility agreements, intercreditor agreements, hedging documentation, legal opinions, security documents and related documentation. Furthermore, he has specific experience in respect of mergers and acquisitions and corporate governance.

YVES RUTSCHMANN

Bredin Prat

Yves Rutschmann has been a partner at Bredin Prat since 2003. He co-leads the firm's tax team and practises in the field of French and international tax law. He specialises in advising on the tax aspects of transactions (mergers and acquisitions, private equity transactions and corporate restructurings) and is particularly highly regarded for his expertise in complex transactions. He also advises corporate clients and their directors in connection with tax litigation matters and tax audits.

He has written numerous articles on tax issues and tax consolidation and also gives lectures in tax law at the French business school HEC Paris.

He was admitted to the Paris Bar in 1995 and is a graduate of the business school HEC Paris (1993) and of the University of Paris Law School (maîtrise and DESS in business law and tax 1994).

GIUSEPPE SACCHI LODISPOTO

BonelliErede

Giuseppe Sacchi Lodispoto is a partner in the banking and finance department of BonelliErede. Giuseppe operates from the law firm's London office and has broad experience in banking and finance transactions, including (among other things) corporate finance, real estate finance, asset finance, structured finance and debt restructuring transactions.

PEDRO CASSIANO SANTOS

VdA Vieira de Almeida

Pedro Cassiano Santos obtained his law degree at the University of Lisbon School of Law and his post-graduate degree in European legal studies at the College of Europe, Bruges, Belgium.

Pedro joined VdA Vieira de Almeida in 1989 and is currently the head partner in charge of the banking and finance practice area, taking responsibility for financial sector clients and transactions. He is regularly involved in the provision of legal advice in banking and capital markets regulatory matters, including the bank recapitalisations and resolutions occurred in the market, as well as in the structuring of financing transactions, such as the issue and placement (both national and international) of debt, hybrid and equity instruments and the issue and placement of warrants and both cash and synthetic financial products. He has also worked extensively in securitisation transactions and other types of asset-backed transactions, together with the preparation of structured finance transactions, in respect of which he is a regular speaker at conferences and a guest teacher on many master's and postgraduate degree courses organised by distinguished institutes and universities.

KEI SASAKI

Anderson Mōri & Tomotsune

Kei Sasaki is a partner at Anderson Mōri & Tomotsune. He studied at Tokyo University (LLB) and New York University School of Law (LLM in international taxation) and is admitted to the Bar in Japan and New York. His practice areas are structured finance, real estate investment and securitisation, project finance, tax planning and tax litigation.

CHRISTIAN SCHMIES

Hengeler Mueller, Partnerschaft von Rechtsanwälten mbB

Christian Schmies is a partner in the Frankfurt am Main office of Hengeler Mueller. He received a Master of Arts in international relations from the School of Advanced International Studies (SAIS) in Washington DC and Bologna, and his legal education from the University of Bonn and obtained a doctoral degree for a thesis on the regulation of hedge funds from the University of Bonn. His practice areas include banking regulation and asset management.

CARRIE B E SMIT

Goodmans LLP

Carrie B E Smit is a partner and head of Goodmans' tax group. Her practice focuses on corporate commercial transactions, cross-border mergers, corporate reorganisations, debt restructurings, domestic and international debt financings, international tax planning and private equity investments. She is the author of many papers on income tax matters and a frequent speaker at conferences. She was the recipient of the Best in Tax award at the 2012 Euromoney Legal Media Group Americas Women in Business Law Awards. She is recognised as a leading tax lawyer by Lexpert*, Chambers Global*, *Best Lawyers in Canada*, Euromoney, *The Legal 500 – Canada* and Law Business Research's *Who's Who Legal*. She is a member of CBA and IFA. A former governor and member of the executive committee of the Canadian Tax Foundation, she was admitted to the Ontario Bar in 1992.

ERIC J STOLLER

Paul, Weiss, Rifkind, Wharton & Garrison LLP

Eric Stoller is practice management counsel in the finance group of Paul, Weiss, Rifkind, Wharton & Garrison, LLP's corporate department, where he assists in the management of the firm's financing practice. Eric has extensive experience in a wide variety of leveraged financing transactions, including acquisition financings, secured and unsecured syndicated bank loans, second-lien financings, mezzanine financings, asset-based loans and restructuring transactions.

KARINE SULTAN

Bredin Prat

Karine Sultan has been a partner at Bredin Prat since 2012 and is a member of the financing team. She specialises in banking and capital markets, with a particular focus on acquisition finance, debt restructurings and real estate financing.

Prior to joining Bredin Prat in 2007, she was with Watson, Farley & Williams and Orrick, Herrington & Suttcliffe.

She was born in Gabon and was admitted to the Paris Bar in 1999. She is a graduate of Lille 2 University of Health and Law (Licence in Private Law 1996), ISC Paris Business School (1996) and Paris Descartes University (Paris V) (DESS in international business law 1997).

ABE SUNG

Lee and Li, Attorneys-at-Law

Abe Sung is a partner in the banking and capital markets department. His main practice areas are banking and structured finance, and he advises many domestic and foreign financial institutions on a regular basis. He has been actively involved in many securitisation deals in Taiwan, leading his colleagues in several pioneering cases, including the first cross-border securitisation deal ever done by a Taiwanese issuer. He also contributed to the enactment of Taiwan's Real Properties Securitisation Law and participated in a number of REITs issuances. According to *Chambers Asia-Pacific*'s survey, clients commend him for combining 'commercial sense with an open mind' and consider him 'the first choice' for structured finance.

In 2002, Abe Sung advised First Commercial Bank in an open bid for sale of non-performing loans, which marked the inception of the NPL market in Taiwan, and since then has advised in more than 30 distressed-asset deals. He also advised Taiwan's Central Depository Insurance Corporation to dispose of the banks in crisis, again setting milestones – in this case, for the smooth transfer of bank assets and for operations to resolve insolvent banks as sound ones.

MONICA K THURMOND

Paul, Weiss, Rifkind, Wharton & Garrison LLP

Monica Thurmond is a partner at Paul, Weiss, Rifkind, Wharton & Garrison, LLP, where she serves as a deputy chair of the corporate department and a member of the capital markets and securities and finance groups. She represents private equity sponsors and their portfolio companies in a variety of engagements such as leveraged acquisitions, first and second lien senior secured debt financings, IPOs, high-yield debt offerings, structured exchange offers, debt and equity tender offers, high-yield bridge financings and consent solicitations. Monica has been recognised by *The Legal 500* and *Chambers USA* for her work in capital markets, including debt offerings, equity offerings and high-yield debt offerings.

MARCEL TRANCHET

Lenz & Staehelin

Marcel Tranchet has a banking and finance practice that includes syndicated bank financings, leveraged finance, structured finance, project finance, workouts and recapitalisations, securities transactions, derivatives and regulatory matters.

Marcel joined Lenz & Staehelin in 2003 and became a partner in 2011. He worked at Cravath, Swaine & Moore in New York in 2005 and 2006. He studied at the University of St Gallen and at the Morin Center for Banking and Financial Law, Boston University.

JAN MARTEN VAN DIJK

De Brauw Blackstone Westbroek

Jan Marten van Dijk is active in the entire spectrum of financing work, with experience ranging from equity issues and bank lending to regulatory matters. His practice covers initial and secondary public offerings and a variety of bank financing transactions, including bilateral and syndicated corporate loans, acquisition financings and debt restructurings. He has acted as lead counsel and local counsel on international transactions, cooperating closely with other top-tier firms in other jurisdictions. He also has in-depth experience in corporate investigations into corporate governance deficiencies and fraudulent actions. Within De Brauw, he is responsible for the Dutch opinion to ISDA on close-out netting under the ISDA Master Agreement.

KASPER VAN LANDEGHEM

Altius

Kasper Van Landeghem has a master of laws degree (*magna cum laude*) from Ghent University and a special degree in financial law from the University of Brussels. He also studied at the University of Glasgow. Kasper joined Altius in 2007. He specialises in banking and finance law. He acts for borrowers and lenders on different finance transactions (including syndicated loan transactions, debt capital market transactions and real estate finance transactions). He also advises various types of clients, including financial institutions (credit institutions, insurance companies and intermediaries), on loan and credit agreements, security interests (pledges and mortgages), finance regulations, regulatory issues, securities regulations, investment funds (undertakings for collective investment), insolvency rules, corporate governance rules in financial institutions, certain aspects of international private law, and consumer credit law. He has written several articles on the Belgian laws on secured lending (in particular on security interests).

NIKOLAUS VIETEN

Hengeler Mueller, Partnerschaft von Rechtsanwälten mbB

Nikolaus Vieten is a partner in the Frankfurt am Main office of Hengeler Mueller. He received a diploma in business administration and his legal education from the University of Wuerzburg and he obtained a doctoral degree for a thesis on constitutional limits to taxation from the University of Cologne. His practice areas include syndicated lending and acquisition finance as well as loan portfolio transactions. From 2005 to 2008, he worked as a director in a principal investment area of a leading international investment bank in London.

L VISWANATHAN

Cyril Amarchand Mangaldas

Viswanathan heads the finance and infrastructure (projects) practice at Cyril Amarchand Mangaldas. He has rich experience in project finance, infrastructure and banking and advises leading corporates, banks and financial institutions. His key areas of specialisation include structured finance, debt restructuring, insolvency and distressed asset sales. He has acted on a number of landmark transactions, including advising Indian lenders on the restructuring of the Dabhol Power Project (2001–2005).

He is currently involved with leading banks and asset reconstruction companies in working through the initial cases under the new Insolvency and Bankruptcy Code, 2016.

Viswanathan has been included amongst the top finance lawyers in India by several leading international legal publications including *Chambers Global 2012* and *Who's Who Legal. Chambers Asia Pacific 2016* states that 'L. Viswanathan is revered by sources as "the best projects lawyer in India". He brings "extraordinary knowledge and his understanding of all aspects of projects in unmatched."' The *Legal 500* (2017) states that 'L Viswanathan has significant expertise in the oil and gas, renewable energy and infrastructure sector.'

He joined the firm (erstwhile Amarchand & Mangaldas & Suresh A Shroff & Co) in 1994 as an associate, and was made partner in the firm in 2000. Viswanathan is registered with the Bar Council of Maharashtra and Goa, India.

HENRI WAGNER

Allen & Overy

Henri Wagner is the managing partner of Allen & Overy in Luxembourg and the partner leading the banking and capital markets department. He specialises in capital markets (including issues on debt and equity securities, securitisations and repackagings, derivatives and structured finance) and international banking work (including syndicated lending, investment grade and leveraged acquisition finance, debt restructuring and financial services regulatory matters). He has more than 25 years of experience working in these areas.

JENS WENZEL

Hengeler Mueller, Partnerschaft von Rechtsanwälten mbB

Jens Wenzel is a partner in the Berlin office of Hengeler Mueller. He received his legal education from the universities of Cologne, Pantheon-Sorbonne (Paris 1) and Heidelberg, and obtained a doctoral degree for a thesis on lending syndicates under German and English law. His practice areas include bank regulatory law as well as financial transactions, including in the renewable energies sector. In 2010 and 2011, he worked as a foreign legal consultant in the Toronto office of Bennett Jones LLP.

DAVID WISEMAN

Goodmans LLP

David Wiseman is a partner in the banking and finance law group at Goodmans. He represents both lenders and borrowers in a broad range of financing transactions, including cash-flow lending, acquisition finance, cross-border lending, asset-based lending, project finance (with a focus on renewable energy), high-yield debt and debt restructurings. He speaks and writes regularly on finance topics and is recognised as a leading banking lawyer by *Lexpert*, *IFLR1000*, *Who's Who Legal* and *Best Lawyers in Canada*, and has the highest possible rating for legal ability and ethical standards from LexisNexis/*Martindale-Hubbell*. He was admitted to the Ontario Bar in 1997.

KENICHI YAMAMOTO

Anderson Mōri & Tomotsune

Kenichi Yamamoto is a partner at Anderson Mōri & Tomotsune. He studied at Keio University (LLB) and the University of California, Berkeley (LLM) and is admitted to the Bar in Japan and New York. He has extensive experience representing major banks, financial institutions, borrowers and investors in corporate lending and financing transactions.

MARK YU

Lee and Li, Attorneys-at-Law

Mark Yu is an associate partner at Lee and Li. He is a graduate of the National Taiwan University law school and has also completed two LLM programmes, at Soochow University (Taiwan) and Northwestern University (United States) respectively. Currently, he is studying on the SJD programme at the law school of Soochow University. He is admitted to practise law in New York State (United States) and Taiwan. Before joining Lee and Li, he was an associate in the tax and legal department of PricewaterhouseCoopers Taiwan.

He focuses his practice on mergers and acquisitions, corporate financing and foreign investment and capital markets. Recently, he worked on the acquisition of RBS NV by ANZ, the tender offer of Galaxy Far East Corp, the syndicated loan to Taiwan High Speed Rail Corporation, the IPOs of Kino Biotech and Sino Horizon, the acquisition by ASML of HMI and aircraft leasing and financing transactions involving CAL and EVA.

Appendix 2

CONTRIBUTING LAW FIRMS' CONTACT DETAILS

ALLEN & OVERY

33 Avenue J F Kennedy
1855 Luxembourg
Tel: +352 44 44 55 1
Fax: +352 44 44 55 557
henri.wagner@allenovery.com
francoisguillaume.deliedekerke@
allenovery.com
www.allenovery.com

ALTIUS

Tour & Taxis Building
Havenlaan 86C B414 Avenue du Port
1000 Brussels
Belgium
Tel: +32 2 426 14 14
Fax: +32 2 426 20 30
kasper.vanlandeghem@altius.com
www.altius.com

ANDERSON MŌRI & TOMOTSUNE

Akasaka K-Tower, 2-7
Motoakasaka 1-chome
Minato-ku
Tokyo 107-0051
Japan
Tel: +81 3 6888 1000
Fax: +81 3 6894 1074
kenichi.yamamoto@amt-law.com
taro.awataguchi@amt-law.com
kei.sasaki@amt-law.com
wataru.higuchi@amt-law.com
www.amt-law.com/en

BONELLIEREDE

30 Cannon Street
London EC4M 6XH
United Kingdom
Tel: +44 20 7653 6888
Fax: +44 20 7248 9228
giuseppe.sacchilodispoto@belex.com

39 Via Vittoria Colonna
00193 Rome
Italy
Tel: +39 06 845511
Fax: +39 06 84551201
raffaella.riccardi@belex.com

www.belex.com

BREDIN PRAT

53, quai d'Orsay
75007 Paris
France
Tel: +33 1 44 35 35 35
Fax: +33 1 42 89 10 73
karinesultan@bredinprat.com
yvesrutschmann@bredinprat.com
mathieufrancon@bredinprat.com
charlottebonsch@bredinprat.com
aurelienjolly@bredinprat.com
anaispinton@bredinprat.com
www.bredinprat.fr

CYRIL AMARCHAND MANGALDAS

5th Floor, Peninsula Chambers
Peninsula Corporate Park
Ganpatrao Kadam Marg
Lower Parel
Mumbai 400 013
India
Tel: +91 22 2496 4455
Fax: +91 22 2496 3666
l.viswanathan@cyrilshroff.com
dhananjay.kumar@cyrilshroff.com
www.cyrilshroff.com

DE BRAUW BLACKSTONE WESTBROEK

Claude Debussylaan 80
1082 MD
Amsterdam
The Netherlands
Tel: +31 20 577 1771
Fax: +31 20 577 1775
jean-marc.rovers@debrauw.com
janmarten.vandijk@debrauw.com
www.debrauw.com

GOODMANS LLP

Bay Adelaide Centre
333 Bay Street, Suite 3400
Toronto
Ontario M5H 2S7
Canada
Tel: +1 416 979 2211
Fax: +1 416 979 1234
janderson@goodmans.ca
cdescours@goodmans.ca
dnadler@goodmans.ca
csmit@goodmans.ca
dwiseman@goodmans.ca
www.goodmans.ca

HAMILTON ADVOKATBYRÅ

Hamngatan 27
Box 715
SE-101 33 Stockholm
Sweden
Tel: +46 8 505 501 00
Fax: +46 8 505 501 01
eric.halvarsson@hamilton.se
fredrik.gillgren@hamilton.se
www.hamilton.se

HENGELER MUELLER, PARTNERSCHAFT VON RECHTSANWÄLTEN MBB

Bockenheimer Landstraße 24
60323 Frankfurt am Main
Germany
Tel: +49 69 17095 0
Fax: +49 69 17095 099
christian.schmies@hengeler.com
nikolaus.vieten@hengeler.com

Behrenstraße 42
10117 Berlin
Germany
Tel: +49 30 20374 0
Tel: +49 30 20374 333
jens.wenzel@hengeler.com

www.hengeler.com

KANNAVA, KITROMILIDOU & CO LLC

3 Markou Botsari
2nd and 3rd floors
3040 Limassol
Cyprus
Tel: +357 25 585583
Fax: +357 25 585582
info@kpklegal.com
www.kpklegal.com

KPP LAW FIRM

10, Paradissou Street
151 25, Maroussi
Greece
Tel: +30 210 3390 341
Fax: +30 210 3390 342
g.kerameus@kpplaw.eu
www.kpplaw.eu

LEE AND LI, ATTORNEYS-AT-LAW

7F, 201 Tun Hua N Road
Taipei 10508
Taiwan
Tel: +886 2 2715 3300 ext 2232
Tel: +886 2 2715 3300 ext 2374
Fax: +886 2 2514 9841
abesung@leeandli.com
markyu@leeandli.com
www.leeandli.com

LENZ & STAEHELIN

Brandschenkestrasse 24
8027 Zurich
Switzerland
Tel: +41 58 450 80 00
Fax: +41 58 450 80 01
patrick.hunerwadel@lenzstaehelin.com
marcel.tranchet@lenzstaehelin.com

Route de Chêne 30
1211 Geneva 6
Switzerland
Tel: +41 58 450 70 00
Fax: +41 58 450 70 01
david.ledermann@lenzstaehelin.com

www.lenzstaehelin.com

MAPLES AND CALDER

75 St Stephen's Green
Dublin D02 PR50
Ireland
Tel: + 353 1 619 2000
Fax: +353 1 619 2001
john.breslin@maplesandcalder.com
david.burke@maplesandcalder.com
www.maplesandcalder.com

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

1285 Avenue of the Americas
New York
NY 10019
United States
Tel: +1 212 373 3000
Fax: +1 212 757 3990
mthurmond@paulweiss.com
estoller@paulweiss.com
www.paulweiss.com

PINHEIRO NETO ADVOGADOS

Rua Hungria, 1.100
01455-906 São Paulo, SP
Brazil
Tel: +55 3247 8400
Fax: +55 3247 8600
bbalducini@pn.com.br
rpanucci@pn.com.br
www.pn.com.br

RAHAYU & PARTNERS LAW OFFICES

Plaza ASIA 18th Floor, Suite D
Jalan Jenderal Sudirman Kav. 59, Jakarta 12190
Indonesia
Tel: +62 21 5152477
Fax: +62 21 5152478
rahayu@rahayuandpartners.com
indra@rahayuandpartners.com
www.rahayuandpartners.com

SLAUGHTER AND MAY

One Bunhill Row
London EC1Y 8YY
United Kingdom
Tel: +44 20 7600 1200
Fax: +44 20 7090 5000
azadeh.nassiri@slaughterandmay.com
kathrine.meloni@slaughterandmay.com

47th Floor, Jardine House
One Connaught Place, Central
Hong Kong
Tel: +852 2521 0551
Fax: +852 2845 2125
peter.lake@slaughterandmay.com

www.slaughterandmay.com

URÍA MENÉNDEZ ABOGADOS, SLP

Príncipe de Vergara, 187
Plaza de Rodrigo Uría
28002 Madrid
Spain
Tel: +34 91 5860 400
Fax: +34 915 860 403
angel.perez@uria.com
pedro.ravina@uria.com
blanca.arlaban@uria.com
www.uria.com

VDA VIEIRA DE ALMEIDA

Av. Eng. Duarte Pacheco, 26
1070-110, Lisboa
Portugal
Tel: + 351 21 311 3677
Fax: + 351 21 311 3406
pcs@vda.pt
ano@vda.pt
rsm@vda.pt
www.vda.pt

WOLF THEISS RECHTSANWÄLTE/ ATTORNEYS-AT-LAW

Schubertring 6
1010 Vienna
Austria
Tel: +43 1 515 10
Fax: +43 1 515 10 25
leopold.hoeher@wolftheiss.com
www.wolftheiss.com

ABA Section of
International Law
Your Gateway to International Practice

Strategic Research Sponsor of the
ABA Section of International Law

Law
Business
Research

ISBN 978-1-910813-74-4